

# 1999 TAX RETURN FILING SEASON AND THE IRS BUDGET FOR FISCAL YEAR 2000

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## HEARING BEFORE THE SUBCOMMITTEE ON OVERSIGHT OF THE COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

APRIL 13, 1999

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**1999 TAX RETURN FILING SEASON AND THE  
IRS BUDGET FOR FISCAL YEAR 2000**

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**TUESDAY, APRIL 13, 1999**

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON WAYS AND MEANS,  
SUBCOMMITTEE ON OVERSIGHT,  
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 1:06 p.m., in room 1100, Longworth House Office Building, Hon. Amo Houghton (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

# ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

## SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE

CONTACT: (202) 225-7601

April 5, 1999

No. OV-5

### **Houghton Announces Hearing on the 1999 Tax Return Filing Season and the IRS Budget for the Fiscal Year 2000**

Congressman Amo Houghton (R-NY), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the 1999 tax return filing season and the Administration's budget request for the Internal Revenue Service (IRS) for fiscal year 2000. The hearing will take place on Tuesday, April 13, 1999, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 1:00 p.m.

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include IRS Commissioner Charles O. Rossotti, representatives from the U.S. General Accounting Office, and professional tax practitioner groups. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

#### **BACKGROUND:**

The 1999 tax return filing season refers to the period of time between January 1st and April 15th when Americans will file over 200 million individual and business tax returns. During this period, the IRS is expected to issue over 92 million tax refunds and answer over 120 million telephone calls from taxpayers asking for assistance.

The Administration's budget requests \$8.2 billion to fund the IRS for fiscal year 2000. This level of funding will support about 98,000 employees who will collect about \$1.8 trillion in taxes, according to Administration estimates.

Beyond supporting the traditional activities of the filing season, the fiscal year 2000 budget request also addresses several additional activities. First, the budget request includes \$140 million to implement the Organization Modernization Concept which would reorganize the IRS into four operating divisions correlated to the needs of taxpayers. The new operating divisions will be: (1) wage and investment income, (2) small business and self employed, (3) large and mid-size businesses, and (4) tax exempt organizations. Second, the budget request includes \$40 million to implement operational changes and new taxpayer safeguards which were contained in the IRS Restructuring and Reform Act of 1998 (Act). Examples of the new taxpayer rights contained in the Act which the IRS is implementing include relief for innocent spouses who filed joint tax returns, and new due process rights in collection actions (such as pre-levy notices). Third, the Act directed the IRS to develop new performance measures to evaluate its employees. One criterion which the Act directed the IRS to use in evaluating its employees was "the fair and equitable treatment of taxpayers by employees." The IRS is still in the process of developing these new performance measures.

In announcing the hearing, Chairman Houghton stated: "The IRS is experiencing a whirlwind of activity this year. The agency is coping with a challenging filing season while it tries at the same time to implement the most significant internal reorganization in 40 years, add numerous new taxpayer safeguards, develop a new system to measure the performance of its employees, and upgrade its aging computer systems while making them Y2K compliant. We want to review the IRS budget and its operations to see if it is meeting all of these challenges in a balanced, timely manner that protects the interests of all taxpayers."

#### **FOCUS OF THE HEARING:**

The Subcommittee will explore how the IRS intends to allocate its fiscal year 2000 budget resources. It will also focus on what effect the IRS funding level will have on its ability to fulfill its basic responsibility of administering the nation's tax laws, while at the same time pursuing a major internal reorganization, implementing significant new taxpayer rights, and assuring that its computers are compliant with the millennium date change (Y2K).

#### **DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:**

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label, by the close of business, Tuesday, April 27, 1999, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, by close of business the day before the hearing.

#### **FORMATTING REQUIREMENTS:**

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at '[HTTP://WWW.HOUSE.GOV/WAYS\\_MEANS/](http://WWW.HOUSE.GOV/WAYS_MEANS/)'.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

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Chairman HOUGHTON. Ladies and gentlemen, I would like to begin this hearing.

I just want to make an announcement. In about 10 minutes we're going to have to go vote. We have two votes, and then that's going to be it for the day. So we will have to adjourn at that particular time.

Anyway, we're delighted to have you here, Commissioner. I would like to say a few words and then turn the mike over to Mr. Coyne for any comments he has.

Today the Subcommittee is going to examine the current tax return filing season and the budget request for the IRS for fiscal year 2000.

The IRS is experiencing a whirlwind of activity. Earlier this year, there was some apprehension about possible difficulty in the current filing season, but the results so far are encouraging. First, there has been a double-digit increase in the percentage of tax returns which taxpayers are filing by electronic submission. Electronic filing means, of course, faster refunds for taxpayers and less paper clutter at the IRS.

Second, the average refund this year has increased to almost \$1,600, which is about 15 percent higher than the average refund last year. The primary reason for the higher refunds probably is the new child credit and educational credits, which Congress passed in the Taxpayer Relief Act of 1997. These new family tax breaks were effective for calendar year 1998, so they are showing up for the first time on the current tax returns.

While the new child credit provides welcome tax relief to working families, the IRS has observed that many families who were eligible for the new child credit were failing to properly claim it on their tax returns. In such cases, the IRS has been taking the initiative by correcting the taxpayers' oversight and sending them the correct, higher refund amount. I believe this action is a good example of positive taxpayer service which hopefully will be more common at the IRS in the future.

We should all breathe a great sigh of relief that the filing season has gone so well, probably better than in any recent years, because the IRS has a lot to do this year, with little margin for error, because of the enormous pressures on it.

Beyond the demands of the filing season, the IRS has several major activities which it is pursuing. First, the IRS is in the middle of the most significant internal reorganization, probably the most significant, in over 40 years. It holds the promise of better taxpayer service, but it also holds the peril of important issues falling through the cracks in the new bureaucratic structure.

Second, the IRS still is implementing numerous taxpayer safeguards which Congress enacted in the IRS Restructuring and Re-



form Act of 1998. This includes an impressive array of new taxpayer rights, as well as congressional direction to establish new performance measures to evaluate IRS employees.

Third, the Service must still complete the upgrade of its computer systems to assure compliance with the century date change, often nicknamed "Y2K".

The IRS has a lot to do in the next few years, and it has got to accomplish these tasks with a relatively flat budget. This will test the ability of the agency to allocate its resources wisely. So today the Subcommittee will review these issues and may be able to find ways to assist the Commissioner in meeting his objectives. So I look forward to hearing the testimony of today's witnesses.

[The opening statement follows:]

**Opening Statement of Hon. Amo Houghton, a Representative in Congress from the State of New York**

Good afternoon and welcome to our hearing. Today the subcommittee will examine the current tax return filing season and the budget request for the Internal Revenue Service for fiscal year 2000.

The IRS is experiencing a whirlwind of activity. Earlier this year there was some apprehension about possible difficulty in the current filing season, but the results so far are encouraging. First, there has been a double-digit increase in the percentage of tax returns which taxpayers are filing by electronic submission. Electronic filing means faster refunds for taxpayers, and less paper clutter at the IRS.

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I look forward to hearing today's witnesses.

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I would ask Mr. Coyne if he has some remarks to make.

Mr. COYNE. Thank you, Mr. Chairman.

Today, the Oversight Subcommittee will hold its annual hearing to review the administration's proposed fiscal year 2000 budget for the Internal Revenue Service and to determine how well the 1999 tax return filing season is going. The issues we discuss here today

are important to the integrity of our tax collection system, and the public's expectations about customer service, fairness, and efficiency.

Last year, the IRS received the resources it needed to do the job. Again, it appears that adequate funding will be provided to the IRS for this coming year. The President's proposed \$8.1 billion IRS budget targets each priority area and does so in an accountable fashion. The budget includes increases of \$250 million for year 2000 conversion activities, \$140 million for organization modernization, \$40 million for implementation of the recently enacted IRS Restructuring and Reform Act of 1998, and \$17 million for customer service training. Also, the budget calls for \$144 million for improved administration of the EITC to strengthen EITC-related customer service, public outreach, enforcement, and research activities.

While it is easy to criticize the tax collector and its work force, I believe that last year proved that such an approach does not solve any problems. Rather, the new and improved IRS will be the result of improved IRS management, employee training, and technology. Implementation of the 1998 IRS reform measures is well underway, and I believe that these changes are having a positive effect on taxpayers nationwide.

Finally, I want to commend the IRS Commissioner, Mr. Rossotti, for his actions, which are geared toward development of a first-class, fair Federal tax system. By all accounts, the current tax return filing season is going well, as the Chairman pointed out. Undoubtedly, the Commissioner's decisions to expand the IRS' hours of operations to nights and weekends, and to shift IRS auditors and collection staff to taxpayer assistance activities, have contributed to a more taxpayer-friendly tax season. At the same time, the Commissioner has streamlined IRS operations and is preparing the agency for the next millennium.

I thank Chairman Houghton for holding this important hearing, and I look forward to continuing our efforts to improve our tax system for all of the taxpayers of the country.

Thank you.

Chairman HOUGHTON. Thanks very much, Mr. Coyne.

Would anybody else like to make a comment or initial statement? If not, Commissioner Rossotti, we're delighted to have you here.

Commissioner ROSSOTTI. Thank you very much, Mr. Chairman.

Chairman HOUGHTON. Again, in just a few minutes we may have to recess for a bit, if you would bear with us, please.

#### **STATEMENT OF HON. CHARLES O. ROSSOTTI, COMMISSIONER, INTERNAL REVENUE SERVICE**

Commissioner ROSSOTTI. Thank you very much, Mr. Chairman, and Mr. Coyne, for your opening comments.

Yes, as you observed, we are having a successful filing season, especially when you consider the challenges and risks that we faced when nearly all of our mission-critical systems were made Y2K compliant and placed back into production for this season. It was just because of that massive amount of change, coupled with the heavy volume during the filing season, that we had the view that we were facing a major risk going into the season.

But, by closely managing this risk and all these changes in an integrated fashion, fortunately, the 1999 filing season has been relatively error free. So probably the most important thing we can say is what did not happen, which is we did not have, at least so far, with a few days to go, major problems.

There is a chart over here which has some arrows on it, which I think is sort of a qualitative way and gives my own personal view of what has been better, the same, or worse, as compared with what we had reason to expect. As you can see, most of the arrows are up.

The electronic filing is up 17 percent overall, and with filing from people with their own home computers, it is actually up 156 percent.

Our website has been extraordinarily successful. We've had over 600 million hits to our website this year, which is more than double the number of hits last year. We did expand the hours of service to 24 hours a day, 7 days a week, and that's a permanent feature which was begun this January.

Now, as you will notice, there's a down arrow there on level of service, phone service. The expansion of service to 24 hours a day, plus the massive amount of training we were doing, did cause us some service problems in the early part of the filing season. So our level of access so far for the cumulative period was only 68 percent this year, compared to our target of 80–90 percent. In the last 4 weeks, however, we have been able to get that back up to 86 percent.

We have also served about 4.3 million taxpayers at our walk-in sites, and we've had, of course, 13 weekends where we've been open on Saturday.

I would also say one of the things we have done this year is to change, and I think make far more stringent, the way we measure our level of accessibility on the telephones and our call quality, to a way that more accurately reflects the actual experience of taxpayers. This will give us the foundation to improve in the future, and we certainly have plenty of room to improve. Many of these improvements in future filing seasons will depend on overall changes we're making in our management, our training, and especially our technology.

I think it's very important to note that this filing season is a very important milestone for the year 2000 program. We now have 93 percent of our mission-critical systems Y2K compliant, and they stood the test during the filing season.

We are now in the process of conducting further integrated tests to integrate our application programs with our vendor-supplied hardware and software, conducting a full-scale test from beginning to end of all of our systems, which will be a major focus for the rest of this year.

Towards the end of this year, in the last phase of our testing, all of the further tax law changes that will be required for the next filing season will be incorporated into our applications, and then we will run this entire environment in a way that closely approximates what we will face after the clock turns on January 1, 2000. So I think we can say that, overall, this is a very positive picture,

but I do want to emphasize that it's not over until it's over, and we still have a considerable number of risks ahead.

Now, as you noted, Mr. Chairman and Mr. Coyne, in your statements, in addition to the filing season and Y2K, we are also managing pervasive change in many other directions and dimensions of the IRS in response to the direction given to us through RRA 98. Some of those are listed on the other chart, there on that second bullet.

I am not going to read them all, but they basically boil down to about 157 near-term initiatives, to improve service and treatment, 1,260 Tax Code changes, planning the reorganization, beginning the replacement of our technology, implementing a whole new set of balanced performance measures, and one that I want to stress in particular is a tremendous volume of training for virtually every one of our 100,000 employees.

So far this year, just in the first half of the year, we have delivered over 6.5 million hours of training, which is almost too big a number to imagine. But it is not nearly enough. Our employees still will tell you, if you talk to them, that they don't feel adequately prepared to cope with all this change. So we have a lot more still to do.

Beyond the current fiscal year, the one that's coming up, 2000, is a big turning point in the overall history of the IRS, as mandated by the Restructuring and Reform Act. We are really looking at the whole agency from top to bottom.

As you noted, we are planning a major reorganization. Some of that will be implemented this year. Much more of it will be implemented during fiscal year 2000.

We have already put in place a new top management team, using the authority that the Congress granted us, and we are implementing new balanced performance measures, as I mentioned.

Updating our business practices and our technology requires almost a complete replacement of this enormous base of technology. We did make a major step in December of last year by awarding a PRIME contract to Computer Sciences Corp., and some other leading companies in the technology industry, to help us update our technology and our business practices that are supported by that technology. We are now in the intense planning phase, working with Computer Sciences and their partners, to begin the first projects later this year.

Just commenting briefly on the budget, we recognize that, despite all these challenges, we're in a tight budget environment. We recognize the stringent funding constraints that exist with budget caps and, therefore, requested what we think is really the bare minimum, \$8.105 billion. It is virtually flat with last year. So we view this as a minimal funding request that is what we need to continue to make some progress on the mandate that we've gotten from Congress.

Some of the key highlights of this funding request are \$40 million for implementing the RRA, customer service and electronic tax initiative, \$17 million for training and tax law training, and \$140 million for the overall modernization program, which includes a significant amount of money, \$36 million actually, for additional training.

So, just to conclude, I think we can say that the '99 filing season has been successful. The Y2K effort has been as it should be, mostly invisible to taxpayers, and we were able to make some improvements in taxpayer service.

We also recognize that fully achieving our mission and our commitment to taxpayers will take a number of years, but we're convinced of the value of this effort and, with the support of Congress and the public, we are confident that we can succeed.

Thank you, Mr. Chairman.

[The prepared statement follows:]

**Statement of Hon. Charles O. Rossotti, Commissioner, Internal Revenue Service**

Mr. Chairman and Distinguished Members of the Subcommittee, I am pleased to appear before you today to discuss the IRS' 1999 tax filing season and some of the initiatives we are undertaking on behalf of America's taxpayers.

INTRODUCTION

The IRS is having a very successful filing season, especially given the enormous challenges and risks we faced when nearly all of our mission critical systems were made Y2K compliant and placed back into production for the 1999 filing season. The massive amount of change made to our systems in the last year, coupled with the extremely heavy volume of processing that occurs during the filing season, posed major risks as we began the season.

However, I am pleased to report that by managing this massive risk and change in an orderly and integrated fashion, the 1999 tax filing season has been relatively error free to date. Projected net collections for FY 1999 are \$1.7 trillion. During FY 1999, we also project to receive 228 million returns, including over 126 million individual returns, and expect to issue over 93 million individual refunds. As of April 2, 1999, refunds are up over four percent over last year, and the average refund is \$1,575. On-line filing is running 156 percent ahead of last year's pace and has already exceeded last year's total volume of 942,000. And of course, the successful completion of the filing season is a major milestone on the road to solving the Y2K problem.

In addition to the Y2K conversion and filing season challenges, we are also managing pervasive change in many dimensions of the IRS in response to the direction given to us by the public and Congress in the IRS Restructuring and Reform Act of 1998 (RRA 98). These include:

- implementing 157 near-term initiatives to improve service and treatment of taxpayers, of which 82 are mandated by the IRS Restructuring and Reform Act of 1998 (RRA 98);
- implementing 1,260 tax code changes from the Taxpayer Relief Act of 1997 and RRA 98, many of which require significant and complex interpretations to guide taxpayers and employees;
- completing the planning for a fundamental reorganization of the IRS to increase accountability for meeting taxpayer needs;
- taking the first steps in a long-term effort to redesign and replace our business systems and supporting information technology;
- implementing a completely redesigned and balanced system for measuring performance throughout the organization; and
- providing essential training related to all these many changes for nearly every one of our over 100,000 full time and seasonal employees.

In summary, much has been done and some critical risks have been managed, but far more change and many more risks lie ahead. Let me briefly summarize the major areas of current activity.

Y2K CONVERSION

The IRS made significant progress in preparing for the Year 2000. As of last month, approximately 93 percent of our mission critical systems were made Y2K compliant and successfully placed back into production for the 1999 filing season.

In fact, as of April 2, 1999, we have processed over 60 million of the 70 million returns received. This is almost two percent more than last year. In addition, any problems that we encountered had a minimal impact on a small number of taxpayers and were generally fixed within 24 hours of being identified. We believe that

the success of this year's filing season is a reflection of the quality of the work being performed to prepare the IRS for the Year 2000.

From April on, most of our efforts will be applied to wrapping up remediation activities on some smaller systems, infrastructure components and most importantly, completing the full-scale End-to-End Testing. While this picture is generally positive, I want to emphasize that there is still risk and a great deal of work to be done.

#### *Ensuring Our Success*

There are a number of factors and efforts that I believe will contribute significantly to a successful Y2K effort.

*Management Commitment.* Y2K is an IRS top priority, as well as one of my own this year. In support of our Y2K repair project, I chair a monthly Executive Steering Committee with representatives from Treasury, the IRS, and the National Treasury Employees Union. In addition, I meet regularly with the IRS' Chief Information Officer and other key executives to obtain individual project status updates, monitor key risks, and to ensure that all necessary actions are being taken.

*Independent Assessments.* In order to validate that we are doing everything possible to ensure that the IRS is Year 2000 compliant, we continue to receive independent assessments of our work from Booz•Allen & Hamilton, Inc. and Northrop Grumman, Inc. Booz•Allen is performing risk identification and assessment on all Century Date Change (CDC) Program activities, while Grumman is performing a 100 percent review of our code renovation. They have reviewed over 75 percent of our code and have found only one in every 30,000 lines of code that requires reprogramming.

*A Flexible Schedule.* The Y2K challenge forces us to continually adjust our schedule and to deploy people and resources to attack the most critical problems. For example, our original schedule was altered for several of our systems due to infrastructure issues. We prioritized our schedule so that systems involved in the filing season were either converted, tested, and implemented in January or held off until after the filing season. If we do not continue to manage risks and schedules in this flexible fashion, we may increase the likelihood of failure and end up delaying, rather than accelerating, actual progress.

#### *Current Priorities*

As we move into the spring of 1999, we will focus our Y2K conversion efforts in a few key areas.

*End-to-End Testing.* Like many other organizations, we are conducting integrated tests to ensure that our Y2K remediated systems will actually function together once we reach January 2000. We have been conducting End-to-End Testing since last July and have been successful to date. As we move towards the summer of 1999, we will begin incorporating more and more of our mission critical systems into the End-to-End tests. These activities leading up to the Fall of 1999 will prepare us for the final phase of End-to-End Testing which begins in October. During this last phase, all of the tax law changes for Filing Season 2000 will have been incorporated into our software applications. This will allow us to run the test in an environment that is as close as possible to what we will actually face in the Year 2000.

*End Game Planning.* We are also devising an "end game" strategy that will guide our activities during the critical "rollover" weekend of December 31, 1999 through January 2, 2000. End game plans will be developed for all of our organizations that are critical to tax processing activities. We will delineate the necessary activities to plan, provide resources and execute response capabilities to mitigate Year 2000 related problems that may affect national tax processing.

*Taxpayer Impact.* Mr. Chairman, in addition to our internal technical challenges, there is a question about the Y2K impact on taxpayers. We want to be sure that taxpayers who attempt to file in good faith or pay on a timely basis are not harmed because of a Y2K computer problem beyond their control. At the present time, the IRS has discretion to abate penalties for reasonable cause, but has only limited discretion to abate interest. We are currently working with the Treasury Department to develop abatement policies and recommendations to address this issue. We will certainly keep the Subcommittee aware of our progress and advise you of any legislative changes that may be needed.

*Contingency Planning.* The IRS is also developing contingency plans that outline the necessary procedures to follow in the event that any of the IRS' mission critical tax processing systems suffer a major failure. These plans concentrate on those areas that have the greatest impact on tax processing activities in addition to the areas we know to be particularly affected by the Y2K problem. We do not think we will encounter such a failure, but it is better to have plans ready in case they are needed.

We are confident that the IRS will be capable of fulfilling its mission in the Year 2000 and beyond. While we recognize that significant risks still exist, we believe that the CDC Program leadership is taking the necessary steps to address them.

As we continue to develop our contingency and end game plans and closely monitor our schedule and progress, we will keep the subcommittee apprised of any Year 2000-related errors, their impact on taxpayers, and our actions to alleviate any taxpayer burden.

#### ELECTRONIC TAX ADMINISTRATION

As the financial world moved toward electronic transactions, the IRS did the same. The opportunity for growth in electronic tax administration is clear. More than 30 percent of American homes now have computers and more than half of those also have modems. An estimated 50 million individuals used some form of Internet application in 1997. Most Americans routinely use credit and debit cards for recurring financial transactions, as well as for major expenditures. In addition, a growing number of state and local governments accept credit or debit cards for payment of taxes and fees.

Industry watchers also predict that an increasing number of U.S. households will do their banking on-line—whether through a dial-up direct connection or through the Internet. An estimated 4.5 million households were banking on-line in 1997. By the year 2000, that figure could swell to 10 to 16 million households.

PC services are also becoming less expensive, or even free. Last year, certain tax software companies offered free electronic filing for the first time and more did so this year. Many financial institutions also distribute free software to account holders who want to do their banking by personal computer.

The challenge for the IRS, in conjunction with the private sector, is to develop products and services that are so simple, inexpensive and trusted that taxpayers will prefer them to the traditional methods of calling and mailing.

Today, I want to highlight our progress in several critical areas this filing season including: electronic tax return filing; electronic payments, and direct deposit.

#### *Individual Taxpayers*

Twenty-five million individual taxpayers took advantage of IRS' e-file options last year. They learned that filing through an authorized practitioner, over the telephone, or on-line is fast, safe and virtually error-proof.

The 1999 filing season is turning out to be another growth year for Electronic Tax Administration as more taxpayers than ever before are enjoying the benefits of filing taxes electronically. Through April 2, 1999, nearly 25 million individual taxpayers filed using one of three convenient e-file options; a 16 percent increase over the same period last year.

- Nearly 18.4 million taxpayers e-filed their tax returns electronically through an IRS-authorized Electronic Return Originator (ERO); a 17.7 percent increase over the same period last year.

- Approximately 1.8 million taxpayers filed their tax returns on-line via their home computer through a third party transmitter. On-line filing is running 156 percent ahead of last year's pace and has already exceeded last year's total volume of 942,000.

- Almost 4.8 million taxpayers filed their returns over the telephone using the award winning TeleFile system. For the first time, taxpayers in Indiana and Kentucky can file both their federal and state returns in a single telephone call during the pilot of the first Federal/State TeleFile option.

- Overall, 7.4 million taxpayers have chosen to file both their federal and state tax returns simultaneously in a single electronic transmission. This year, 35 states and the District of Columbia are participating in the program.

In addition, this filing season the IRS is conducting two pilots which provide a paperless filing experience for thousands of taxpayers. These pilots involve the use of Personal Identification Numbers (PIN) as the taxpayer's signature, thus eliminating the need to file the paper signature *jurat*.

- Nearly 452,000 taxpayers have participated in the On-Line Signature Pilot where the IRS distributed e-file Customer Numbers to taxpayers who prepare their own returns using tax preparation software to file from their home computers.

- Another 322,000 taxpayers have participated in the Practitioner Signature Pilot where taxpayers choose a PIN when filing through 8,100 participating practitioners.

Also new this year, taxpayers filing balance due returns have several options for not only filing electronically, but paying electronically as well.

- Over 33,000 taxpayers filing balance due returns paid using an Automated Clearing House (ACH) debit as part of their electronic return. Taxpayers can file early and have the debit occur as late as April 15th.
- Another 5,600 taxpayers used credit cards to pay the taxes due as part of two credit card pilots that the IRS is conducting this year. Under the first pilot, US Audiotex (San Ramon, CA) is processing credit card payments over the telephone. After e-filing by computer—either from home or through a tax preparer—or by TeleFile, a taxpayer can charge the balance due with a toll-free phone call. US Audiotex is accepting MasterCard, Discover or the American Express card. In the second pilot, individuals using Intuit's (Mountain View, CA) TurboTax or MacInTax software to e-file from their computers are able to use a credit card to pay the balance owed to the IRS. Taxpayers can charge their balance due to a Discover Card brand.

#### *Business Taxpayers*

Business taxpayers are also benefitting from the wide range of electronic filing and payment options that are available to them.

- On February 16, 1999, the IRS announced that taxpayers have made more than \$2 trillion in tax deposits electronically since the government established the Electronic Federal Tax Deposit System (EFTPS) in November 1996. Over two million businesses are now enrolled in the Hammer Award-winning EFTPS system which allows taxpayers to make their federal tax deposits over the telephone or by using a personal computer, eliminating the need for paper deposit coupons, checks, or trips to the bank. During FY 1998, taxpayers made \$1.2 trillion in tax deposits through EFTPS which accounts for over 80 percent of all federal tax deposits.
- During Fiscal Year 1998, 750,000 quarterly employment tax returns were filed over the telephone by small businesses, in addition to the nearly 582,000 Forms 941 that were filed electronically by payroll service providers. In FY 1999, the IRS expects over 2.3 million Forms 941 to be either filed electronically or over the telephone.
- Under the Simplified Tax and Wage Reporting System (STAWRS), the IRS is working with other federal agencies and states to reduce employer burden by conducting single point filing projects in the states of Iowa and Montana, establishing a Harmonized Wage Code database, and improving customer service.

#### *Planning for the Future*

In addition to successfully managing the current filing season, the IRS is also planning for the future. As required by the IRS Restructuring and Reform Act of 1998, the IRS issued its first-ever Strategic Plan for Electronic Tax Administration for public comment on December 3, 1998. The Strategic Plan is designed to eliminate barriers, provide incentives and use competitive market forces to make significant progress toward the congressionally mandated goal of 80 percent of all tax and information returns being filed electronically by 2007.

As also required by the Act, the IRS established last year the Electronic Tax Administration Advisory Committee (ETAAC) to provide an organized public forum for the discussion of ETA issues in support of the objective that paperless filing should be the preferred and most convenient method of filing tax and information returns. The ETAAC, which is comprised of representatives from various groups including tax practitioners and preparers, transmitters of electronic returns, tax software developers, small and large businesses, employers and payroll service providers, individual taxpayers, state governments, and financial industry members, provides continuing input into the development and implementation of the Strategic Plan for Electronic Tax Administration.

### PROVIDING INFORMATION AND SERVICE TO TAXPAYERS

From web-based technology to 24-hour-a-day/7-days-a-week phone service to sitting down one-on-one with a taxpayer with a problem, the Internal Revenue Service is working to provide the easiest and most efficient ways for taxpayers to get the information and assistance they need not only during filing season, but throughout the year.

#### *Web Site*

An increasing number of taxpayers are discovering that the IRS home page on the World Wide Web ([www.irs.ustreas.gov](http://www.irs.ustreas.gov)) is an excellent and convenient source for tax forms and tax information. And they can get them around-the-clock, 365-days-a-year and from anywhere in the world. Since coming on line in January 1998, taxpayers have downloaded over 69 million forms, publications and products. For the



first two months of the filing season there have been over 24 million downloads as compared to 9.4 million for the same period in 1998—an increase of almost 150 percent.

Anyone with Internet access can receive: tax forms, instructions, and publications; the latest tax information and tax law changes; tax tables and rate schedules; and hypertext versions of Publication 17, “Your Federal Income Tax” all TeleTax topics; answers to the most frequently asked tax questions; a library of tax regulations; the weekly Internal Revenue Bulletin, which contains all the latest revenue rulings, revenue procedures, notices, announcements, proposed regulations and final regulations.

#### *Web Site Alerts*

This filing season, the IRS also created a new page found on its web site to alert taxpayers and practitioners about problems that could affect them. Similar to a product recall notice, the “Special Taxpayer Alert,” describes the problem, its scope—such as the number of people likely to be affected, where they are located—and most importantly, what the IRS is doing to fix the problem, and what, if anything the taxpayer needs to do about it. In most cases, taxpayers do not have to take any action. However, if they want more information, taxpayers can call our toll-free, 24-hour-a-day/7-day-a week phone number 1-800-829-1040.

Thankfully, there were few problems to report on the “Special Taxpayer Alerts Page.” The alerts we posted included: a report that some employees received W-2 forms from their employers that had an “X” in or near an incorrect checkbox, a printing error in Form 4562 (Depreciation and Amortization) and a production delay for Package 1040-ES/V (Estimated Tax for Individuals) due to ice and snowstorms.

#### *Web Site Small Business Corner*

The Small Business Corner located on the IRS web site was inaugurated in January 1999 to benefit the over 23 million small business taxpayers and the 800,000 start-up businesses begun each year. It is intended to provide these taxpayers with easy-to-access and understand information. This type of convenient “one-stop shopping” for assistance could provide most, if not all of the immediate products and services that a small business needs. It also offers the potential for Web-based Q&As which can help the IRS identify and address trends and systemic problems. Improved electronic access to information should also result in decreased demand for telephone and walk-in assistance.

#### *Expanded Web Site Tax Professional Corner*

The Tax Professional’s Corner of the IRS’ web site was developed to provide a quick listing of the information resources most needed by Tax Professionals. It provides news items, early release of items to be issued in the Internal Revenue Bulletin, drafts of revised forms, e-file resources and links to the most technical items on our site. The twelve categories of information will continue to be expanded.

#### *Web-based Customer Service*

This filing season, the IRS continues to provide interactive e-mail customer service to taxpayers on the web site. This capability is very limited and was conducted as a test of the capability, and is not necessarily a permanent addition to our customer service offerings.

We are also offering interactive help in navigating our web site, assistance with certain Employment Tax Issues, and help for certain priority programs like the Banks, Post Offices and Libraries Program and the Corporate Partnership Program. Users in these areas on our web site will be able to e-mail their questions without leaving the site. It will use intelligent routing to get the question to an available assistor, who then researches and responds by “pushing back” a hot link URL providing the answer to the user. If this pilot is successful, we will expand it to cover other functions responsible for customer service. We are currently exploring future possibilities for this application with our internal customers.

#### *CD-ROM*

The Federal Tax Forms CD-ROM contains more than 600 tax forms and instructions, and some 3,000 pages of topic-oriented tax information. Users can electronically search, view-on-screen, or print-out any of the items contained on the CD. Available through the Government Printing Office’s Superintendent of Documents, the three-issue subscription is \$25. As of March 22, 1999, almost 65,000 subscriptions were sold.

In conjunction with the Small Business Administration, the IRS also recently produced the joint small business CD-ROM, “Small Business Resource Guide: What

You Need to Know About Taxes and Other Topics.” It is an interactive multi-agency product utilizing the latest technology to provide the small business taxpayer with easy-to-access and understand information. A total of 17,000 copies will be available for distribution; half of which will go to SBA Small Business Information Centers.

Similar to the web-based “Small Business Corner,” the information is organized by stages of the business life cycle and provides guidance on preparing a business, financing a business, record keeping, selecting a business structure, employment tax information and other important topics. All of the business tax forms and publications are available, most in fill-in-the-blank and/or searchable format. For those users with Internet access, there are also direct links to the web sites of most federal regulatory and state tax agencies. The CD-ROM will be tested at strategic locations, such as the SBA’s Business Information Centers.

#### *TAXI On-line Learning Lab*

In July of 1998, the Internet application TAXI went live. This is an on-line learning lab for first-time taxpayers, students aged 13–18, who learn about taxes in school. It covers the reasons we pay taxes and how the students can meet their tax obligations. Particularly important is the availability of electronic filing options and teaching early on the benefits of electronic filing. First time taxpayers will learn electronic filing methods rather than paper-based filing and how to interact electronically with the IRS. This was a successful collaborative effort between IRS and the American Bar Association’s Section of Taxation. Additional modules are planned as follow-ons to the existing four units.

#### *IRS Local News Net*

IRS Local News Net is a list server which supplements the web site’s Digital Dispatch (there are over 40,000 Digital Dispatch subscribers) by providing localized, targeted and immediate information for tax professionals. It is a system capable of reliable and efficient delivery of information to the tax professional community across the nation.

The system is structured to support the localized nature of information based upon the tax professional’s specific local needs. Any District Office, Service Center or Computing Center that needs to communicate with the public or with tax professionals on a regular basis can request a list server. Local News Net Servers are being developed primarily to reduce the print and postage costs incurred with the Director newsletters.

### TELEPHONE ASSISTANCE

#### *24/7 Phone Service and Access*

One of the hallmarks of the IRS’ new commitment to providing top quality service to taxpayers is 24 hours-a-day/7 days-a-week toll-free telephone service (1-800-829-1040) which we began on a trial basis at the end of the 1998 filing season. So-called “24/7” phone service became a permanent IRS service feature on January 4, 1999. As of March 27, 1999, more than 28 million taxpayers have been served, compared to almost 30 million over the same filing period last year.

As the subcommittee is aware, the expansion of hours of service to 24 hours/7 days a week, combined with increased training demands to implement the new tax law and preceding requirements, did cause the effective level of service to decline, especially during the beginning of the filing season. For the season as a whole so far, our level of access is 68 percent in 1999 compared to our target range of 80–90 percent. In the last four weeks, however, the level of access averaged 88 percent.

One of the very important steps we are taking to improve telephone service is to change the way we measure service and quality to better reflect the real world way that taxpayers receive it. These are more stringent, but also more useful ways, of measuring.

Concerning access, we have begun to measure the percentage of calls in which the taxpayer receives actual service, in relation to the percentage of time the taxpayer simply gains access to our system. In terms of call quality, we are now rating the quality of a sample of actual taxpayer calls and rating those who receive complete and accurate service, as well as technical tax law or account accuracy.

In order to deliver truly high quality communication to taxpayers, we need to improve the management, organization, technology and training that support these operations. This is a major objective of our overall modernization program.

### *Forms By Fax*

Taxpayers can receive about 100 different tax forms 7 days-a-week, 24-hours-a-day from IRS TaxFax. In addition to forms and instructions, taxpayers can receive faxed copies of TeleTax topics and small business newsletters. Taxpayers use the voice unit of their fax machine to dial the service at 703-487-4160. The only cost to the taxpayer is the cost of the call.

### *Recorded Tax Information*

TeleTax has 148 topics available 24 hours a day using a Touch-tone phone. Taxpayers can call (toll-free) 1-800-829-4477 to hear recorded information on tax subjects such as earned income credit, child care/elderly credit, dependents or other topics such as electronic filing, which form to use, or what to do if you cannot pay your taxes. Nearly nine million taxpayers used TeleTax last year for recorded tax information; as of March 27, 1999, over six million have taken advantage of the service.

### *Automated Refund Information*

Last year more than 52 million taxpayers used the Automated Refund Information system on TeleTax to check on the issuance of their refund checks. As of March 27, 1999, the number stands at nearly 22.5 million. Taxpayers may call 1-800-829-4477 to check on their refund status Monday through Friday from 7 a.m. to 11:00 p.m. if using a Touch-Tone phone, or 7:30 a.m.—5:30 p.m. for rotary or pulse service.

## WALK-IN ASSISTANCE

### *Saturday Service*

Delivering on its promise to supply even more reliable and helpful taxpayer assistance, the Internal Revenue Service provided Saturday walk-in service during the 1999 filing season on 13 Saturdays at nearly 262 locations nationwide, compared to six Saturdays in 178 locations in FY 1998. As of March 27, 1999, we served over 122,000 taxpayers on weekends. So far this filing season, we have served over 4.3 million taxpayers at all of our walk-in sites—a five percent increase over last year.

The Saturday Service sites were selected based on their weekend accessibility, year-round operational status, and high traffic volume, including 32 non-traditional locations, such as shopping malls, community centers and post offices.

On each of the Saturday Service Days, IRS employees provided taxpayers with the following services: (1) distribution of forms and publications; (2) answers to account and tax law inquiries; (3) verification of Individual Taxpayer Identification Number documentation; (4) processing of alien clearances; and (5) acceptance of payments.

The first six Saturday sessions focused on assisting low-income taxpayers who may be eligible for the earned income tax credit (EITC). We assisted over 15,000 EITC taxpayers through March 27, 1999 compared with about 4,000 during the last filing season.

### *Problem Solving Days*

Problem Solving Days continue to be a great success story on the problem resolution front. Begun in November 1997, over 32,000 taxpayers have taken advantage of this innovative program. Monthly Problem Solving Days are held at all IRS District Offices and taxpayers can make an appointment to meet with IRS personnel to resolve special tax problems they have. In addition, many taxpayers who called to set up an appointment for a Problem Solving Day had their problems resolved over the phone, and never had to come in person.

Taxpayers comment that they like the opportunity for face-to-face contact and that they appreciate that someone is listening to them and trying to resolve their problem. Employees also respond favorably to Problem Solving Days. They especially like the multi-functional approach to problem solving which ensures that the taxpayer's problem can be heard by someone with the right set of skills to help resolve the issue.

Both taxpayers and employees recognize that not all of the issues coming in during PSD will be resolved in favor of the taxpayer. Audits must still be conducted, and IRS is not offering amnesty. Taxpayers do, however, appreciate the opportunity to sit down with someone to discuss the issue at hand and get a complete explanation of what needs to be done even if the result may be different from their expectations.

Mr. Chairman, as I testified earlier this year at the subcommittee's hearing on the Taxpayer Advocate's Annual Report to Congress, the taxpayer advocates have

built a lot of equity into Problem Solving Days and I want to see it continue, but more importantly, I want to build these practices into our everyday treatment of taxpayers. The taxpayer advocates can also help us solve the recurring, systemic and practical problems that plague the IRS. From their many meetings with taxpayers, including Problem Solving Days, they see trends and patterns emerging. If they help us diagnose these overarching taxpayer problems, the National Taxpayer Advocate and I will do our best to get the right prescription to cure them.

#### *Volunteer Programs*

During FY 1998, over 3.5 million taxpayers were assisted by more than 39,000 IRS Volunteer Income Tax Assistance volunteers and more than 32,000 Tax Counseling for the Elderly volunteers at a combined 16,500 sites. Last year, 2,400 VITA and TCE sites also provided e-file to over 400,000 taxpayers.

We also opened up VITA and TCE offices that were in locations close to our walk-in offices observing EITC awareness day. Our volunteer programs are set up in shopping centers, libraries, churches and community centers. This provided an additional avenue of support to taxpayers visiting an IRS office for EITC assistance.

In addition to this type of volunteer assistance, our outreach program targeted EITC education and assistance. We identified EITC coordinators in our offices who are responsible for the full complement of our EITC outreach activities. Since the end of February, this program has reached nearly 100,000 EITC taxpayers through social workers, community organizations, homeless shelters and similar organizations.

#### *The IRS Corporate Partnership Program*

The IRS Corporate Partnership Program expanded dramatically; far beyond the initial goal of 500 companies and 600,000 employees. There are now more than 2,100 companies with more than 13 million potential employees in the program who can get forms through the corporation's Internet site or local LAN. The program has also grown by 210 members as a result of a side bar 'link' on the IRS web site.

#### *Forms Simplification Research*

For the 1999 filing season, 11 new forms were developed and 177 forms and instructions and 39 publications were revised.

In 1998, the IRS conducted focus groups to obtain taxpayers' feedback on the new form and worksheets developed for the child tax credit. For the first time, we provided access to draft 1998 tax forms on the web site to obtain comments from practitioners and others about new and revised forms. In prior years, only paper copies of draft forms were published and distributed for comment. We have also added worksheets from publications to the web site. These worksheets supplement existing forms when an extra calculation is needed to compute a credit, exclusion, or a deduction.

During 1999, our tax forms and publications personnel are working with an outside contractor to redesign the earned income credit and child tax credit forms and instructions. As part of the project, focus groups were conducted using the current IRS products. After redesign, focus groups will be conducted to test taxpayers' reactions.

Also in development is a forms simplification research plan that will provide strategies for moving taxpayers to the simpler tax forms and for targeting where revisions are needed.

#### *Tax Package Innovations*

The 1998 Form 1040 tax packages were revised to provide more white space and increase the print size of the text for improved readability. Throughout Form 1040 packages, and on the covers, tax law changes for 1998 are highlighted, including the new child tax credit (generally \$400 per child), the education credits, and the deduction for student loan interest. To protect taxpayers' privacy, their Social Security numbers are no longer preprinted on the peel-off label sent with the tax package. This change is highlighted on the covers, in the "What's new for 1998" section of the packages and on the front of the tax return by reminding taxpayers to enter their social security numbers on the return. We also moved information about other sources of assistance, such as Forms by Fax, near the front of the tax booklet.

For better customer service, other changes were made to the 1998 individual tax forms and packages. In case the IRS needs to contact the taxpayer while the return is being processed, there is an optional space for the taxpayer to enter a daytime telephone number. The tax packages will also include more information about the Problem Resolution Program.

### *Newspaper Supplement Program*

The Newspaper Supplement Program promotes distribution of IRS forms in selected areas that do not currently have sufficient outlets for tax products. There are currently 13 newspapers enrolled in the program with a circulation of 1.57 million readers. Each newspaper distributes six pre-selected tax items (Forms 1040, 1040EZ, 4868, Schedules EIC, A&B, and Publication 2053, Quick and Easy Access to IRS Tax Help and Forms) in one of their upcoming Sunday editions. The IRS will supply the newspapers with enough forms to satisfy one Sunday circulation. All participating newspapers distribute in one or more of the counties identified as needing additional tax form outlets.

### **MORE TAXPAYER RIGHTS**

The 1999 filing season brings a major expansion in taxpayer rights due to the landmark IRS Restructuring and Reform Act of 1998. From new rules ranging from protecting innocent spouses to burden of proof to greater power for the National Taxpayer Advocate, taxpayers are finding an array of new options available to assist them.

Delivering on the new law and the hundreds of specific changes to both the tax code and our organization is an enormous task. As I previously noted, we are in the process of: (1) implementing 157 near-term initiatives to improve service and treatment of taxpayers, of which 82 are mandated by the Restructuring Act; (2) implementing 1,260 tax code changes from the Taxpayer Relief Act of 1997 and the Restructuring Act, many of which require significant and complex interpretations to guide taxpayers and employees; and (3) providing essential training related to these many changes to nearly every one of our over 100,000 employees.

The IRS is fully committed to implementing these laws and changes on behalf of America's taxpayers. However, as in any cases where there is such a multitude of change, problems and mistakes may occur and timetables may need to be adjusted.

### *Strengthening Taxpayer Advocate*

The power of the National Taxpayer Advocate was significantly expanded by the Restructuring Act which both enhanced the role and independence of the National Taxpayer Advocate. The expansion includes creating a national system of taxpayer advocates serving in local IRS offices. These local taxpayer advocates also work independently, reporting to the National Taxpayer Advocate rather than to the IRS' examination, collection and appeals functions. The Act also increased the presence of local taxpayer advocates so that one will be available to taxpayers in each state.

One of their tools is the Taxpayer Assistance Order, which can be requested by a taxpayer suffering or about to suffer a "significant hardship" involving tax law administration. The orders can be issued if the National Taxpayer Advocate determines a significant hardship exists that justifies granting the emergency assistance order.

### *Easier Access to The Problem Resolution Program*

This filing season, the National Taxpayer Advocate also spotlighted the Problem Resolution Program with a new toll-free number for people with long-standing tax troubles. The hotline for help—1-877-777-4778—is available for taxpayers who have not been able to promptly resolve problems through normal IRS channels. The call puts taxpayers in touch with the trouble-shooters at the Problem Resolution Program. A personal taxpayer advocate will be assigned to each taxpayer to help clear up problems and ensure each case is given a complete, impartial review. For routine questions, taxpayers are asked to first call 1-800-829-1040 before calling the Taxpayer Advocate's Problem Resolution Program number.

### *Citizen Advocacy Panel*

On March 16, 1999, National Taxpayer Advocate Val Oveson introduced the Brooklyn District's Citizen Advocacy Panel (CAP), bringing the total number of panels to four. There is now a CAP in each of the four geographic regions of the United States. The other three are located in the South Florida District (Ft. Lauderdale); Midwest District (Milwaukee); and the Pacific Northwest District (Seattle).

CAP members are non-tax experts from the local community who will help identify problems and make recommendations to improve IRS systems and operations. The CAPs have a number of benefits. They will help the IRS identify taxpayer issues and concerns; give taxpayers a voice; and provide an additional avenue for taxpayer access to problem resolution procedures.

## 1999 REVENUE PROTECTION STRATEGY

During the 1999 filing season, validation of Social Security Numbers (SSNs) and other tax identification numbers will continue to be a very visible portion of our fraud and abuse prevention efforts. In 1998, there were 3.4 million occurrences on the electronic filing system of missing, invalid or duplicate uses of SSNs causing tax returns to be rejected back to the transmitter.

We are expanding the validation of SSNs/TINs to virtually all forms and schedules requiring identification numbers. We will identify dependent SSNs claimed on more than one return and improper claiming of children for the dependency exemption and/or EITC. Taxpayers with incomplete returns, invalid or duplicate SSNs, or returns demonstrating patterns consistent with suspicious claims or profiles can expect their refunds to be delayed or disallowed pursuant to "math error" procedures or audits.

We will also continue the EITC Communications Strategy which is composed of three parts:

- *Awareness.* Taxpayers and practitioners need to understand the EITC eligibility rules and the consequences of non-compliance.
- *Deterrence.* We will inform taxpayers and practitioners of planned compliance and the penalties for intentional non-compliance.
- *Prevention.* We will publicize availability of free return preparation assistance and electronic filing provided on a pro-bono basis or through VITA and Tax Counseling for the Elderly.

A major component of the communications strategy, an in-depth review of EITC related forms, schedules, worksheets, instructions and publications, is currently underway. This process is a joint effort with IRS and an external consultant. The goals are to revise and simplify the forms and instructions to increase understanding and awareness of eligibility rules and to streamline the process to compute the EITC amount accurately.

Starting in 1999, under new tax law rules, we will issue math error notices if EITC is claimed on the 1998 return and recertification is required, but Form 8862, Information To Claim Earned Income Tax Credit After Disallowance, is not attached to the return. Recertification is required if the tax year 1997 return was audited and EITC was not allowed. The entire refund, or in some cases, only the EITC portion of the refund will be held until the recertification form is reviewed, or until an audit is conducted to verify entitlement. Both processes provide an opportunity for taxpayers to furnish the necessary information or documents to prove EITC eligibility.

The IRS will maintain the enforcement segment of the Revenue Protection Strategy by maintaining the resource levels dedicated to the investigation and prosecution of taxpayers and tax return preparers involved in fraudulent refund schemes. Resources remain available to audit returns in specific problem categories as well as for those individuals required to recertify entitlement to EITC. Monitoring visits to Electronic Return Originators (EROs) will continue to ensure compliance.

For the fiscal year ending September 30, 1998, IRS Examination closed approximately 295,000 cases with recommended assessments of \$454 million. Fewer resources were expended to collect these assessments since many of the returns claimed refunds, which were not issued until, or unless eligibility was verified. Also, at the end of the fiscal year, approximately 500,000 returns identified during the 1998 filing season were still in the audit process.

Through September 30, 1998, we identified over 2,800 fraudulent refund schemes involving multiple returns for paper and/or electronically-filed returns. We detected more than 26,000 fraudulent returns and prevented the issuance of over \$65 million in refunds. Furthermore, over 400,000 questionable returns that did not warrant criminal investigation were referred to Examination.

## MODERNIZATION AND FY 2000 BUDGET REQUEST

Fiscal years 1999 and 2000 represent a crucial turning point for the IRS. In this period we are aggressively addressing the problems described by Congress and the American people over the past few years. As mandated in the Restructuring and Reform Act, the IRS is expected to do a far better job of serving the public based on an much better understanding of the taxpayer's point of view. Delivering on this mandate is our top priority in the FY 2000 budget.

The problems that led up to the passage of the Restructuring Act can be solved but they will require fundamental change in order to modernize almost all aspects of the IRS. This process also carries with it considerable cost and risk. Our plans may need to be revised and operational problems may occur. However, there is no

low risk plan for the massive job we must do at the IRS that I described at the beginning of my testimony.

We will complete the plan for our new organization structure this year and have already begun implementing parts of it. Much more implementation will occur in FY 2000. Using the authority granted by Congress, we also have put in place a new top management team and are actively recruiting to fill leadership positions in our new operating divisions.

Updating our business practices for dealing with taxpayers requires almost a complete replacement of IRS information technology systems, which are built on a 30-year old fundamentally deficient foundation that cannot provide accurate up-to-date information about taxpayer accounts. And GAO has repeatedly reported IRS cannot provide reliable financial information to manage the Agency. On December 9, 1998, the IRS awarded a Prime Systems Integration Services Contract (PRIME) to Computer Sciences Corporation (CSC) and their partners. We are currently working with CSC to update our strategic systems plan and to implement near-term projects which will focus on improved phone service and electronic filing options.

Despite these many challenges, in preparing the budget request for FY 2000, we are well aware of funding constraints and have therefore requested the bare minimum. Without this funding, the entire reform and restructuring program demanded by Congress and the public could stall and the risks increase.

The FY 2000 resource request of \$8.105 billion will enable steady progress on the many changes needed to deliver on the reform and restructuring program and the Year 2000 Conversion. This request in total is essentially level with resources provided in FY 1999, which totaled \$8.125 billion including \$505 million from the Y2K emergency fund.

- This is an unlikely combination—major changes requiring investment with a flat budget.

This combination is only possible in FY 2000 for three reasons: first, because of the stringent fiscal constraints we are carrying out many of the changes by diverting resources from on-going programs such as compliance; second, the Congress advance funded our ITIA to a level that will sustain us through FY 2000; and third our current estimates of specifically identified and known year 2000 costs are less than the costs for FY 1999.

These three factors enable us to include in our budget request some absolutely essential items for implementing the required changes. These include \$40 million for implementing the Restructuring Act's customer service and ETA initiatives, \$17 million to train our employees in the tax laws that Congress passed; and \$140 million for implementing the modernization plan called for in the Restructuring Act which will increase accountability for service to specific groups of taxpayers. The money for implementing the modernization plan will be used to reorganize and provide new skills for the IRS workforce.

I want to particularly stress that increased training of our employees is essential for delivering on the mandates that Congress gave us and the service that the public expects. About 70% of IRS employees deal directly with taxpayers. Taxpayers have every right to expect that in every such encounter with an IRS employee, whether it's a phone call asking a question about how to fill out a return, or a meeting with a revenue agent in an audit, the IRS employee should understand the current tax law and have the skills to understand the facts and circumstances of that taxpayer. A year ago, when I took office, it was abundantly clear that there was already a serious deficit in this area. Since then, Congress has given us the responsibility of implementing 1260 changes to the Tax Code and a mandate to restructure the whole way we do business with taxpayers. The money in the budget request, including that part included within modernization program, is essential and will only begin to rectify our training deficit.

Overall, this budget will continue the trend of the last six years in which the IRS workforce has been shrinking in relation to the size of the economy. In FY 2000, while the workload grows as a result of the growth in the economy and the additional demands of the Restructuring Act, the total workforce size will remain approximately constant. This trend will only be possible if we make the investments in organization, training and technology that are needed.

#### CONCLUSION

Mr. Chairman, on balance, the 1999 tax filing season has been successful. The concurrent Y2K conversion effort was virtually seamless to taxpayers and we were able to make some significant strides to improve taxpayer services. Granted, many of the changes needed to carry out our new mission statement, such as reorganizing our outdated structure and replacing our archaic technology will take years. That

does not mean, however, that we cannot get everyone in the organization working today to understand what we are trying to accomplish and to take some important steps forward in the right direction. We are convinced of the necessity and value to America's taxpayers of reaching this higher level of performance. With the continued support of the Congress and the American people, we are confident we can succeed. Thank you.

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Chairman HOUGHTON. Thanks very much, Commissioner.

I want to ask just three questions, and then I will pass it along to my other associates here.

First of all, let me say that I think you've done a wonderful job. The IRS is an entirely different organization since you've been there. I'm sure others before you have done their part, also, but it has peaked. The efficiency, the cost control, the services and everything, I think is extraordinary. However, I have three basic questions.

First of all about people. I understand, in order to keep your costs down, that you have not hired people in I don't know how many years—five, six, seven, something like that. I wonder whether that's a smart idea, because, as we all know, when you pull back out of the market for people and then go in again, it takes many years to sort of get your identity back there. Also, if you don't have younger people coming in, you're not refreshing—As I understand, you're average age is going up.

Now, you can't do everything. Obviously, you tried to balance this thing out. But that's one question.

Second, I understand that you've got a goal of something like 80 percent of electronic filing by the year 2007. But in your own documents, you say that by the year 2005 it's only going to be about 30 or 33 percent. I don't know how you're going to get there.

Then the third issue really is one of tax simplification, how you're going to come on that. So maybe you would like to wait on those things, ponder them a little bit, and then we'll be back as soon as we vote.

OK, we don't have to leave now. Go ahead.

Commissioner ROSSOTTI. Well, I think those are all very important questions. Let me deal with the people question first.

I think you have put your finger on one of our major problems, but it's a long-term problem. If you look at the current total staff of the IRS today, it's about 15,000 fewer than it was 5 years ago. The only way that has been achieved is by essentially cutting off virtually all hiring and by allowing a reduction in the work force with those who leave not being replaced.

To show you how serious this is, just to take one occupational category as an example, the IRS revenue agents are one of the major occupational groups. Those are the people who actually go out and audit tax returns and know the tax law. There's about 14,000 in that occupation in the IRS.

We're losing about 450 revenue agents a year just from normal retirements. In the last 4 years, we have hired exactly 28 revenue agents, virtually none. Basically there has been none.

If you went through the other occupational groups—for example, special agents, who are the criminal investigators, we have hired



about four criminal investigators. It's essentially none. There has basically been a hiring freeze.

What I have proposed with the budget we have submitted is that we would at least have enough money to resume hiring to replace those who leave, not to increase the total size of the staff. I think that's a reasonable approach. But we need to have assurance that we can have this funding for a number of years because you can't hire people and then get rid of them the next year.

So I think we have a strategy to deal with this, but it is a major turnaround from where we have been in this agency.

With respect to the electronic filing, we do have a plan in place. This year we'll have about a quarter of the returns actually filed electronically. By 2005, our current projections, which are a wide range, because it depends on what we do, would actually have somewhere between 45 and 60 million returns. So, especially if we can hit the upper end of that, it would be closer to about half, as opposed to the lower percentage.

But I think the key point to make here is that "business as usual", just keeping going and hoping that we will grow, will not get us to the goal that Congress has set. We have to do more aggressive actions than that. Part of those have to do with the technology programs that we're attempting to implement.

So part of the planning is to identify the gap that you have to solve in order to reach your goal, and we recognize there is a gap and there are additional steps that we need to take, some of which are identified in our plan.

I'm sorry, Mr. Chairman. I forgot what the third question was. I didn't write it down.

Chairman HOUGHTON. Simplification.

Commissioner ROSSOTTI. Oh, simplification. Yes.

Well, of course, the major role of the IRS is to help the taxpayers and work with the taxpayers to comply with the law as it exists, and it's mainly the responsibility of the Treasury, the administration and Congress, to work on the Code itself.

However, there are some new things in the Restructuring and Reform Act that give the IRS some role in this. One of the most important is the Taxpayer Advocate, who has been given the job of reporting to Congress on observations that he has from working with taxpayers on the problems that are caused by the administration of the Tax Code. Of course, he reported to this Committee earlier this year, and he is also reporting to the Senate Finance Committee, as a matter of fact, on Thursday, in a hearing they're going to have on complexity of the Tax Code. That is a voice that has been given by Congress to us to, I think, be one of many voices to try to hopefully deal with or at least contribute to the debate on complexity.

I really think this is a case where it is not the primary role of the IRS, but perhaps we can be a player or contributor to your leadership and your debates on how to deal with issues of complexity.

Chairman HOUGHTON. Thank you.

Mr. Coyne.

Mr. COYNE. I have no questions.

Chairman HOUGHTON. Mr. Portman.

Mr. PORTMAN. Mr. Commissioner, thank you for your testimony today, and congratulations on the relatively smooth filing season. I just have a few questions regarding the IRS Restructuring and Reform Act and its implementation.

The Chairman was talking earlier about your electronic filing, goal to reach 80 percent by 2007. As the Chairman knows, that's in the Restructuring and Reform Act, through this Subcommittee, and we're the ones putting your feet to the fire on that. I think that's appropriate.

But everything that has been addressed in the opening statements and in your testimony practically comes out of the Restructuring and Reform Act and, therefore, this Subcommittee has a special interest in it and really a responsibility to make sure it's being implemented right.

I think of the IRS reorganization, which is in the Act. Just looking at your testimony, the balanced performance measures, which is a major change at the IRS and is going to take some time to see whether that is working well. But it will fundamentally change the incentive system at the IRS, instead of being statistics driven. This is a major change the Subcommittee took the lead on, and electronic filing, the goal we talked about, the computer technology, the funding for that, the way in which we're asking the IRS to not only modernize but do it with regard to special funding that we have provided for that, the Taxpayer Advocate you just mentioned, totally restructured under the Restructuring and Reform Act.

There are more than 50 new taxpayer rights that, of course, you addressed in your op ed yesterday with Mr. Rubin and so on. Your own term for 5 years, the flexibilities that you have to be able to hire people, as you talked about bringing in top people. This all comes under this substantial, the first time since 1952, major reform of the IRS that this Subcommittee took the lead on.

The one piece that is missing here—and you and I have talked about it—is the Oversight Board. It is so important. The reason we thought it was essential to put in place a private/public oversight board was to ensure that these reforms, in fact, do take place, and to ensure, frankly, that after Charles Rossotti is gone—and I hope that's not for a long time—that there is somebody there who understands and has some continuity as to the institutional memory of the place and why we're making these reforms and keeping them going, and to bring in the knowledge and expertise that we've talked about from the outside, to be able to make sure these reforms really work. And finally, accountability.

I would just like to make a very strong statement today on my behalf and on behalf of the U.S. Congress, that passed this legislation overwhelmingly, that we are deeply disappointed that the Clinton administration has yet to send nominees to the U.S. Senate. It violates the law, not just the spirit but the letter of the law. This was to be done 6 months after enactment. The enactment was last July, 8 months ago. The date, I think, was January 22. Still, the nominations have not gone to the U.S. Senate.

Until we have this Oversight Board in place, we will not feel as though we have even taken the first step toward implementing the IRS Restructuring and Reform Act. I hope other Members of this Committee, on a bipartisan basis, will join me today in urging you

to do all you possibly can to get the White House to follow the law, to establish this board that is so essential.

My question to you today, I guess, without trying to put you on the spot, would be twofold. No. 1, do you believe this board would be helpful in going forward in your efforts to reform and reorganize the IRS?

Commissioner ROSSOTTI. Well, based on the time I've had in office, I would say that I believe it will be helpful, very helpful, and for exactly the reason that was contemplated, I think, in the legislation and the preceding commission, which is that if it works as intended, we will have a group of people who have continuity and who have hopefully the incentive and the time to actually learn in detail about these very complex programs, technology and other things that we're implementing, to give us critical feedback. I mean, it's just what a corporate board does; give us critical feedback, but also I believe, if we're on the right track, give us some validation and support from a group of people that represent the public interest in an informed and ongoing way. Those are what I see as the benefits of the board being.

Let me just say I'm looking forward to having this board to work with, as soon as it becomes operational.

Mr. PORTMAN. My second question, Mr. Commissioner, would be do you have any update for the Subcommittee today on the status of those nominations going to the Senate?

Commissioner ROSSOTTI. It's my understanding that the nominees are going through what's called the "vetting" process, which means the FBI and other background kinds of checks that need to be done, which takes some time, as I remember from my case. That's the best information I have.

Mr. PORTMAN. The final question I have for you is, we talk a lot about these reforms. Back home we're hearing from our constituents, "Gee, it's still April 15, we still have to pay our taxes, we're still not getting through on all the phone calls—" and that's one area where I'm disappointed we haven't been able to increase the phone answering this year.

Tell us what you think about a timeframe in terms of making the kind of cultural changes that you talked about so articulately, in terms of changing the mentality at the IRS to more of a service organization, to make it, indeed, more taxpayer friendly?

Commissioner ROSSOTTI. Well, I think you mentioned two things there that are related but not the same. In terms of the phone service, this is partly a cultural change, but it has a lot more to do with very practical issues, about technology and training.

I mean, the thing that we did this year was to extend the 24-hour, 7-days-a-week phone service. I think this is important for a lot of people. On Monday I had a hearing before the Small Business Committee, and the point was that small business people often during the regular working hours can't take time out to talk to the IRS. So having that service at other hours is important.

But that is not a simple thing to do, when you have 20,000 people around the country that are, in part at least, answering phones. So getting that 24-hour service organized is something that was very, very challenging, in terms of the scheduling and the training of the people to do that. It actually had the effect, unfortunately,

of actually reducing our level of access, at least in the first part of the season.

The other thing is, just management and technology, one of the first things that we're going to be doing under the new technology blueprint is putting in some new technology to manage the phone traffic, the Internet traffic. Right now we don't really have the right kind of technology to effectively manage that.

This is the first year, for example, in the whole history of the IRS, that we actually have data that tells us, in the right level of detail, what the nationwide phone traffic is, in terms of different kinds of calls and where they should be going, which is absolutely essential as a foundation in beginning to plan how to provide good service.

So the issue of phone service is not simply a matter of decreeing well or a cultural issue of getting people to be more friendly on the phone. It's a very major logistical and training operation to make this happen.

Having said that, I think the cultural issue you raise has to do with a number of things, both—I'll call them tangible and intangible things. On the intangible side, but yet important, are things like what we have done, in terms of simply stating a 27-word mission statement that clearly states exactly what the mission of the agency is. I think if you go in any desk today in the IRS, even a data transcriber in the service center, you are likely to see this little card that we've given to every employee that clearly sets, in the first words, to provide top quality service, to provide American taxpayers top quality service through these various means.

The other thing is, as you mentioned, changing the system of measurements. You do communicate what you value in an organization by how you reward people, by how you measure organizational performance.

In the past, as I think has become evident from the hearings and other things we've done, there was a very strong emphasis on one part of what the IRS does, which is enforcement revenues. It's an important part, but it's 2 percent of the total revenues we collect. I don't mean to say that we don't need to do enforcement because we do. But if that's the sole or almost principal thing that you measure, you know, that's going to drive a lot of things that you do. That has been an issue that has bounced around the IRS for over 40 years.

The hard thing is to figure out what you put in place of it. I think we have worked very hard and it has actually been our first priority in terms of implementation, even before these other things. We are now rolling out in this fiscal year a system of balanced measures, which does have customer satisfaction as a factor, as well as quality of work that is done and employee satisfaction, as well as quantity, and not really focused on enforcement revenues.

That is probably one of the most important things that we can do, to communicate to the entire work force what we really value.

Now, we have to back that up with training. I again stress that training is one of our most important short-term challenges. We have requested significant funding, or at least some additional funding in the budget, and I can't stress too hard—In fact, if you look at these manuals over here, these four binders, that is what

is called IRM 21. This is the set of manuals right here, those four volumes, that represent what the 21,000 customer service reps, most of whom are GS-8s, are expected to know in order to be able to deal with incoming phone calls.

This is changing all the time because of the 1,260 tax law changes that were put into place this season. So if you stop to think about what that means, that's a regular challenge. Now, we shouldn't even have these manuals on paper. We should have all of this in the form of computer-accessible, searchable text, which we're starting to put through in many of our sites, but we don't have it at all of our sites yet.

Mr. PORTMAN. The point is, these changes won't take place overnight. I congratulate you on the filing season and your progress so far.

Thank you, Mr. Chairman.

Chairman HOUGHTON. OK. Mr. Hayworth.

Mr. HAYWORTH. Thank you, Mr. Chairman.

Commissioner Rossotti, I want to thank you very much for coming down to update us on this. Before I turn to my questions about the tax filing season, I wanted to let you know I have some questions about the draft Low Income Housing Tax Credit Audit Technique Guide that's been developed by the IRS. I will submit those questions to you in writing and would appreciate you getting back to me on that matter.

Would that be OK?

Commissioner ROSSOTTI. Sure.

Mr. HAYWORTH. Thank you, Mr. Commissioner.

Well, you offer very graphic evidence of the challenge that confronts and confounds not only your customer service representatives but those of us on this Committee, in terms of the Tax Code changes that developed. It is something to look at those four volumes to offer yet another compelling sight for all of us to be mindful of the fact that the system has grown so cumbersome and so complex that we do need to be about the business of simplification, from our end as well as from yours, as you are trying to reorganize.

You brought up the whole notion of e-filing. I know that, as the Chairman outlined in his introductory comments, there remains some concerns about Y2K. But my concerns, Mr. Commissioner, are more elemental, just in terms of security, for the lack of a better term, for those returns that are filed via home computer.

Have you detected any attempts to "hack" into the system? Have there been any problems or breaches of security? And furthermore, about the whole issue of taxpayer privacy, something that we addressed as we were trying to expand the rights of taxpayers last year, legislatively.

Does the electronic filing perhaps lift the veil of privacy that taxpayers are entitled to?

Commissioner ROSSOTTI. Let me just say that in our whole electronic filing program, one of the major considerations in our ability to expand it is to ensure that we have adequate security and privacy. This is one of the things that we have to constantly work on and it constrains us, frankly, on how fast we can move ahead with things, like using the Internet, which as you know has major security issues.

As it is now, most of the electronic filing that currently is done, the 30 million or so, does not come through the Internet. It comes through the ordinary phone network. It comes from what are called electronic return originators through to providers that come to us through secure channels. So I think we can be very reassuring to taxpayers that, as the current system works, it is secure and there is no violation of their privacy.

But going forward, as we try to expand the number of ways that we give to taxpayers to file electronically, this is one of the major considerations that we are working on. We have, within our chief information office organization, a whole office that is basically the security and privacy office, whose sole job is to look at everything we do from the point of view of privacy and security. We also have outside contractors, like Mitre Corp., for example, that work on the intelligence systems for the Defense Department, that advise us on these security issues.

So if we were not concerned about these security issues in a very, very serious way, we could probably expand the options for filing and paying quicker, but we can't do that. We have to make sure that we do protect the privacy.

Now, insofar as hacking and so forth, of course, our website is subject to attack, as any website is. It is outside, however, our firewalls and is totally apart from our other taxpayer system. So we have been able to maintain security in that fashion.

I don't want to minimize this threat. Just like good service and compliance are two things that have to be weighed, convenience to taxpayers and privacy are two things that always have to be weighed. This is what makes it challenging, to be able to accomplish our service goals.

Mr. HAYWORTH. Let me turn back to the human equation, if I could, Mr. Commissioner.

I recall last year the whole notion of the problem-solving days, where taxpayers and several of my constituents had the opportunity to sit down face to face with someone from the Internal Revenue Service, who helped them with a particular tax problem. And while we move and make great strides electronically, I know it's very important to keep the human part of the equation into this. As we all agree, just as you're testifying personally here today, there is no substitute for this eye-to-eye, face-to-face contact.

Do you plan more problem-solving days in 1999?

Commissioner ROSSOTTI. We do. We have problem-solving days every month, as a matter of fact. We're continuing to do that. We have two kinds. We have some that are planned locally, where they are conforming to what the local need in that district or territory is, and then we have a couple of national problem-solving days to get the publicity. So we are definitely doing that. We're going to continue doing that. It's been extremely successful.

But I also want to note that we're trying to draw the lesson from problem-solving days in building our whole new organizational structure in the future. We know that there are some taxpayers, because of their personal preferences, but also in some cases just because of the complexity of issues, who do have to sit down face to face.

So our whole design for our new structure is to allow the taxpayers to choose the best way for them to deal with us. Many taxpayers would rather deal over the Internet and phone from their offices. We want to make that much more convenient than it is now.

We are also planning to have a whole network of offices that will essentially have problem-solving days every day, if you will, as part of their built-in structure, as we go forward. So we would basically allow the taxpayer to make a choice based on their preferences and their situation on what is the best way to deal with us.

Mr. HAYWORTH. Commissioner, I thank you very much.

Mr. Chairman, thank you for the time.

Chairman HOUGHTON. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman.

Commissioner Rossotti, you don't have to respond to policy questions here, but if you care to, feel free. Capital gains and the AMT—how are members of the public reacting to the complexity of those issues? Are they taking more time asking questions of your staff? Do you think they're spending more time with those forms? Is there any relief in sight?

Commissioner ROSSOTTI. Unfortunately, filing season is not over yet, but we will compile statistics and analyses on what has happened during the filing season with different kinds of forms and so forth. But, regrettably, I just don't have any meaningful information on that right now.

Mr. NEAL. You don't have any anecdotes from staff members?

Commissioner ROSSOTTI. Well, we know there are taxpayers that are claiming things like the child credit and the student loan credit and so forth.

As a matter of fact, if you want an anecdotal piece of information that shows why things are not always as simple as you might think, we're up 17 percent in electronic filing. But in one part of our electronic delivery system, which is the Telefile, where for the really simple returns, you just dial in on a touch tone phone and dial in your return, we're actually down slightly on those, even though it was growing fast before.

We think that the reason that's the case—although we don't have proof of this yet—is many people that use that simple method are students, and since there are more opportunities now for students to claim, for example, deductions on interest and credits, which can't be done through telefile, they have been driven to a more complex form. So you have these kinds of things that go on.

But at this point, honestly, I think I'm just giving anecdotal information. I really don't have a meaningful analysis at this point.

Mr. NEAL. Commissioner, I understand that, with the 15th approaching, some of this data has yet to be secured. But, at the same time, the Taxpayer Advocate has noted these problems along the way. These clearly are problems that this Congress, hopefully in this session, is going to have to address. Taxpayers are filling out more forms, and they get more confused about the forms as they fill them out.

I'm not arguing here that we did not have good intentions. I'm simply pointing out that the result has been less than what we had desired.

Commissioner ROSSOTTI. Yes.

Mr. NEAL. Thank you, Mr. Chairman.

Chairman HOUGHTON. OK. I think we ought to recess now. We'll be back after the second vote. Thank you very much.

Do you have time?

Commissioner ROSSOTTI. Yes, sir.

Chairman HOUGHTON. Thank you.

Commissioner ROSSOTTI. My time is your time.

[Recess.]

Chairman HOUGHTON. All right, if we could reconvene.

Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman. Mr. Commissioner, thanks for bearing with us through our votes today.

I have just a couple of questions. As a preface, it's interesting that you're here this week, and thank you for giving us time this week.

I insist on doing my own taxes at home. My wife is truly the classic "innocent spouse" when it comes to that. I will tell you as well that I'm proud of my legal background, and I have taken every tax law course the University of Mississippi offered when I was going to school there. I have to tell you, that the time the IRS has estimated as far as us muddling through these forms is on the low end. I just mention that to you, as someone who really does go through this exercise every year.

As I have been going through that process, I have been thinking about electronic filing, because we've been talking a lot about it and we've been encouraging the American people to do it. So I have been keeping in my mind ways to make it easier for taxpayers to participate in electronic filing as I consider myself to be just an average American citizen trying to pay taxes on time.

One of the concerns that I have about that is some of the impediments that might prevent taxpayers from filing electronically. For instance, are taxpayers allowed to file the supporting schedules electronically or not?

Commissioner ROSSOTTI. Well, in some cases yes, in some cases no. I mean, the difficulty that we have right now is that, because of the technology limitations, we can't accept all forms and all schedules. That is exactly, as you point out, one of the things that is a barrier that limits how many people can file. In our strategic plan, that is one of the things we're working on. Of course, our goal is to have you file all forms and all schedules. It's going to be a couple of years before we reach that.

Mr. HULSHOF. Let me also talk about what I think motivates people to file electronically. Of course, people who believe they're going to get a refund of what they've overpaid to the Federal Government, those people are more likely, of course, to file electronically, as opposed to, say, someone who has a balance due.

How do we motivate those taxpayers with balances due to file electronically? Do you have any ideas on that?

Commissioner ROSSOTTI. Yes. I think there are two things that we're doing. One we basically need to inform and educate taxpayers about. If you have a balance due, and you have to send in a paper check, you still have to send it in an envelope and that kind of reduces the incentive.



We have now this season, for the first time, put into place a way that you can actually pay electronically, through credit cards and debit cards. Congress gave us that authority. Now, on the credit cards we still have a problem—a little bit of a barrier, if you want to call it that—because Congress said we were not allowed to pay the credit card companies a fee, so it's the taxpayer that has to pay a fee for the use of the credit card, as opposed to the normal case, where the seller provides it. But still, it is a convenience. This will be the first year that we've had those services available.

But the other thing that is really important is that, from the taxpayer's point of view, the chance of an error occurring on electronic returns is very, very minimal. On a paper return, just because of the inherent process of paper, they're higher.

The best way to reduce burden on a taxpayer, as well as reduce the cost to the IRS, is not to have any more transactions at all after you file that return. The taxpayer does not want to receive one of those infamous IRS notices, and we don't want to send the taxpayer notices just because of some error that may have occurred. So that is an advantage to the taxpayer.

The final thing is, you do get an acknowledgement if you file electronically, so you have clear evidence that you filed the return. So I think by making it possible to file all forms and schedules, by making it possible to pay as well as file electronically, and by the benefit of accuracy and acknowledgement, we give some incentives.

I think the last point is the fact that a lot more people are starting to use their tax preparation software in their home PC, which is a benefit to the taxpayer—

Mr. HULSHOF. Right.

Commissioner ROSSOTTI. And once you've got that on your computer, you just push the button and you go.

Mr. HULSHOF. Right.

Let me ask you, because my time is dwindling, it was last December, I think, that the Internal Revenue Service awarded the PRIME contract to Computer Sciences Corp., obviously to help upgrade the computer system. Again, when I was first honored with a seat on this Committee, before your tenure, we had many discussions—and maybe some of those behind you recall those discussions—about the moneys appropriated for the computer technology for the Internal Revenue Service, where we head in one direction and suddenly have to go in a different direction, at a loss of taxpayer moneys.

Also, with the indulgence of the Chairman, this has not been identified in the FY 2000 budget. Should it be, and can we expect in future budgets that we're going to see a line item as far as the amount of moneys for the computer system?

Commissioner ROSSOTTI. Yes.

Let me just answer the last question. The reason it was not identified in fiscal year 2000 is because, in the previous 2 fiscal years, Congress did set up what was called the Information Technology Investment Account, and there's \$500 million that's been appropriated which we have not tapped any of yet, because we wanted to make sure that we had all the things in place that we need to have in place to be able to manage that kind of a huge program wisely. One of those was getting the PRIME contract awarded.

There were several others that we're working on. One of them is updating our strategic plan. So we are hoping that, beginning in July of this year, or let's say the summer of this year, that we will first go back to get the approval to begin to use that account. But we will not need any additional appropriation in fiscal year 2000 for the program.

Now, in fiscal year 2001, we have actually asked for an advanced appropriation because, once we get started, we've got to really sustain this program.

Let me just say this is one of the biggest challenges that we have in the IRS. We really have to go back and replace these computer systems. Just to give you one example, all of the taxpayer records in this country are on a computer system that was designed during the Kennedy administration, and it's on tape files. None of us has seen a tape file in at least 15 years.

This is really an impediment to service; it's an impediment to good accounting controls that GAO wants; and it's a huge job to replace it. So we're going to take it very cautiously, but once we get going, we want to sustain that program over a period of years.

Mr. HULSHOF. Thank you, Mr. Commissioner, and thank you, Mr. Chairman.

Chairman HOUGHTON. OK. Fine.

Mr. Coyne has a question.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. Commissioner, the administration has requested \$8.1 billion for the budget for the year 2000, \$8.1 billion, and it's very close to the levels appropriated for 1999.

Why is it important that the Service receive the full amount that's been requested?

Commissioner ROSSOTTI. I think it's important that we receive this funding—in fact, I would say it's essential that we receive this funding—simply to fulfill the mandate that Congress has given us and I think the public expects, as documented in the Restructuring and Reform Act.

This is a major, major change. I think both the Chairman and you noted this in your opening remarks. This includes near-term things that we have to do, such as implement 71 taxpayer rights provisions. We have about 2,500 people that are being reallocated just for fiscal year 2000 to implement these rights. And then we have the things that we have to do to fix some of the major underlying problems of the agency, such as the reorganization and improved management structure and, most importantly, the technology.

Last, of course, but a part of these other programs, is the training that we have to do. We have a horrible training deficit. We have to begin to do what the Chairman noted in his question to me earlier, which is begin to have a plan which will actually refresh the personnel staff, to begin to hire to replace people that are leaving the agency. Without doing these things, we really have no chance of delivering on what I think the public expects, and of really administering the law in a fair and equitable way to the 123 million individual taxpayers.

So those are, I believe, critically important requirements that are necessary in order to deliver on what the Congress and public have told us they want us to do.

Mr. COYNE. If the IRS was not to get the \$8.1 billion requested, what programs would go unfunded?

Commissioner ROSSOTTI. I think the basic point is that we have already stretched all the diversions that we can do, so we would be into basically slowing down or delaying or not proceeding with some of the major reform efforts that I think we've committed to. We haven't really done a contingency plan, because I don't think there is a good contingency plan.

Mr. COYNE. Thank you, Mr. Commissioner.

Chairman HOUGHTON. Mr. Watkins.

Mr. WATKINS. Thank you, Mr. Chairman, and Commissioner Rossotti.

As you know, the Arkansas-Oklahoma district had some big time problems a couple of years ago. Have most of those been resolved?

Commissioner ROSSOTTI. Well, it certainly was the case that there was a good deal of contention and a whole range of what I would call human kinds of problems in that district, especially in Oklahoma. I've gone out there and visited.

We do have a new management out there—

Mr. WATKINS. I've seen that.

Commissioner ROSSOTTI. I think that there were some local problems there that related to individuals in management, but there was also an overlying problem that I think happened to coincide with the local problems, which had to do with—I'll call it the overuse and overemphasis on enforcement statistics as a way of measuring performance, which put a lot of pressure on people. You put those together with the local problems and you had, as you know, some very difficult situations.

Mr. WATKINS. You might like to know, Commissioner, that I've had extensive townhall meetings back during the President's work period in February, and just now coming off the Easter break and work period. I have to share with you that it's the difference between daylight and dark from what it was 2 years ago.

Commissioner ROSSOTTI. What was that?

Mr. WATKINS. It's a lot better.

Commissioner ROSSOTTI. Thank you.

Mr. WATKINS. We don't always jump just every time someone says something, but I have received less complaints this time. I do get some that I question myself, and when I think they're not legitimate I kind of check them out and call them back. My district is mainly small towns and everyone knows everybody else. So if you know someone, you can call and say, "Hey, let me ask you this. Is this person shooting straight or is this person—" and they usually can tell you what's been going on in those communities.

I just had one a couple of days ago, and after I checked it out, I didn't even follow it back up. I thought it was not one that—so usually you can find out about some of those along the way. And there are some that you feel are very legitimate and you would like to get some folks to follow up on, hopefully in a very cooperative way.

But I think there are a lot less problems out there. I think I concur with most of the comments that have been made by the Chairman and others. I want to salute you and your staff for trying their best. You know, we deal with a thousand and one problems up here, and we'll never solve them all, but we'll try to do the best we can.

I do have one question, and maybe you can get me with the right person to follow up on this. There's a little family in the hometown where I lived for a number of years, a mom and pop type operation, a family that had a lady bookkeeper and secretary. They found out, after letting her go as a disgruntled employee, they checked and realized that this lady had not been taking proper care of the books. She was the bookkeeper.

They called the IRS to report the problem, which I thought was a very good move. They called and said they had found a problem here. They have gone about making sure they paid the taxes when they realized it. But now they're going to be penalized big time, and they said they didn't think they would have that situation. I kind of concur. It looks like kind of a double-whammy on them. They are a working family, a family-type business situation.

I was wondering, would you mind if I met with one of your staff people and—

Commissioner ROSSOTTI. Certainly. That's the kind of problem that we have the Taxpayer Advocate for. What I would like to do is get the Taxpayer Advocate locally there in touch with you and your office.

Mr. WATKINS. I have used a couple of times the Taxpayer Advocate. I don't know if—It seems like on this particular case I have had them involved, because I've had my staff involved there.

Commissioner ROSSOTTI. I think that's exactly why we've got them, to deal with those kind of cases. They can look into it and take the taxpayer's point of view and see what we can do in dealing with those issues.

Mr. WATKINS. I would appreciate it.

Commissioner ROSSOTTI. We'll get in touch with your office and do that.

Mr. WATKINS. I try not to—Like I say, I screen a lot of these myself, because I know everyone is going to have complaints.

Commissioner ROSSOTTI. That's fine. I appreciate that. That's why we have the Taxpayer Advocate. We have beefed that up significantly. We're doing a lot to make it more effective. There are always going to be concerns like that. We'll get them in touch with you.

Mr. WATKINS. I know you're continuing to refine it and fine-tune it. Just like most of us up here, we're trying to do our job. But I just had extensive townhall meetings this past 2 weeks, and like I said, in February, and I think there's a tremendous amount of difference this year than what it was even a year ago.

Commissioner ROSSOTTI. That's good to hear. Thank you. We'll get in touch with your office and find out how we can help that taxpayer—this was in your district?

Mr. WATKINS. Yes, in my district.

Commissioner ROSSOTTI. We'll get the taxpayer advocate out in Oklahoma to deal with that.

Mr. WATKINS. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you, Mr. Watkins.

Commissioner, I understand that Mr. Portman has arranged a brief colloquy with you about tornados in his district. Would you like to kick off?

Mr. PORTMAN. Thank you, Mr. Chairman. I appreciate it.

Commissioner, as you know, we've had a terrible tornado that ripped through the heart of the district I represent. We've had about 800 homes damaged or destroyed and a lot of businesses destroyed. That happened last Friday, and four people were killed and a lot injured. Many folks are without a home tonight. The area has not yet been determined to be a Federal disaster area. The request has been made to FEMA and they're doing evaluations as we talk.

In my view—and I think you share this view—the April 15 filing deadline should be the last thing on these folk's minds, as they begin to put their lives back together. We have coordinated with the IRS to ensure that administratively help is available, and I want to thank the district office, Ashley Bullard, for having an IRS representative at my office today, which is only a few miles from where all this devastation took place. They will be there until the 15th to help taxpayers in filing for extensions, receiving replacement refund checks, and expediting the processing of any refunds.

My question to you, sir, is whether you can provide us with your assurance that all appropriate administrative remedies will be taken to assist these taxpayers during this ordeal.

Commissioner ROSSOTTI. Mr. Portman, I couldn't concur more, that if somebody has had tornado damage or a home destroyed, that the last thing they need to worry about is taxes. So I give you my assurance that whatever powers we have to mitigate any consequences for taxpayers, we will definitely do those.

I think, as you noted, you were in contact with our district director out there, Mr. Bullard, and he will have the authority to help the taxpayers any way we can, within the limits of our authority.

Mr. PORTMAN. Can you tell us a little bit more about the efforts you normally would undertake to assist disaster victims? Again, we don't have the disaster declaration yet, but if we were to get that, perhaps what you could do in that case as well.

Commissioner ROSSOTTI. I think part of those things we are already doing, such as putting people in your offices, and we have a special hotline, a local phone number there. We can expedite refunds; we can get lost refunds to people; we can extend the time to file, so that they don't have to worry about the penalties. These are things we can do and are doing in the situation that exists now.

I think what happens, if we get the declaration that it is a disaster area, we get the additional authority—for example, to abate interest. Today, even though you extend the time to file and pay, you can still be liable for the interest. That is not an authority we can have under the current circumstances, that we would be able to have with the aid of it being declared a disaster area.

Mr. PORTMAN. Thank you very much.

I appreciate the time, Mr. Chairman. I guess all Members of the Committee have to deal with this at one time or another, and it's

helpful to know the IRS has some administrative procedures where they can help the victims of a tornado. Thank you.

Chairman HOUGHTON. Thanks, Mr. Portman.

Mr. Commissioner, I just have one final question. There has been some publicity recently about the IRS steadily reducing the audits in the nineties. Would you like to make a comment about that?

Commissioner ROSSOTTI. Yes, indeed. There was a story in the New York Times, for example, on Monday, that talked about that.

I think the important thing to understand about the audits is that audits are some of the most labor-intensive things that we do. By definition, they're a one-at-a-time kind of a thing, so they are directly related to how much staff time we have and the number of people that need to be audited.

I think what has happened, say, over the last 10 years is that the economy has grown substantially, while the staff of people to do audits has been reduced. So clearly, you're going to have to do less audits.

Now, on top of that, what has happened is the economy has not only grown in terms of total growth, but the number of more complex and, let's say, higher income returns has grown even more. So you have a situation where you have rapidly growing numbers of high-income returns, and you have a declining number of auditors or examiners. Clearly, the audit rate is going to go down, particularly the face-to-face, more labor-intensive audits. So the numbers that were in the newspaper articles are accurate and they do reflect a substantial decrease.

Now, the whole approach that we have tried to propose to deal with not only audits but the whole issue of compliance going forward is to, first of all, recognize that we do have to have the budget to at least stabilize the size of the IRS. We cannot continue to lose revenue agents, lose people and not replace them, because of the very reasons that you noted in your questions, Mr. Chairman, and also just because of the growth in the economy.

However, I do think that we do not have to go back and add large numbers of people to just do things the way they were done 5 or 10 years ago. Through the use of better management and better technology, we can target these audits to where they need to be and make that just one part of our overall compliance strategy and use that approach to try to live within the means that we have available to enforce the laws and ensure compliance.

If modernization, as we call it, is designed to be a balanced program that recognizes that the majority of people do want to pay their taxes, then we want to make it easy and efficient and then we want to use our enforcement resources in a highly efficient and targeted way where that's really necessary. That's what the whole strategy is.

But we cannot continue to lose our auditors while the economy grows and expect to be able to administer the law.

Chairman HOUGHTON. Right. I guess the thing I was trying to search for is that, in order to have an auditing function, you must have a critical mass of audits to make them meaningful, other than just passing over the transom and just saying you have an auditing function and really, in effect, not.

I would be interested if you could have one of your people send us sort of a concept of what you're trying to do. I understand that statistically you can do much more and much faster, and you don't have to have quite as extensive an audit as you had in the past, but there comes a point below which you obviously don't want to go. It's too long to discuss it here, but I think it would be interesting if you could have a follow up on that.

Commissioner ROSSOTTI. Yes, sir. We will do that.

Chairman HOUGHTON. Are there any other questions? If not, thank you very much, and congratulations for the great job you're doing.

Commissioner ROSSOTTI. Thank you very much, Mr. Chairman.

Chairman HOUGHTON. Now I would like to call the second witness, James R. White, Director, Tax Policy and Administration Issues, General Government Division of the U.S. General Accounting Office.

All right, Mr. White. You may proceed.

**STATEMENT OF JAMES R. WHITE, DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY DAVE ATTIANESE AND GARY MOUNTJOY, ASSISTANT DIRECTORS**

Mr. WHITE. Mr. Chairman and Members of the Subcommittee, I am pleased to be here to discuss IRS' proposed budget for fiscal year 2000 and give a status report on the current 1999 filing season. Accompanying me are Dave Attianese and Gary Mountjoy, both GAO Assistant Directors with experience on IRS matters.

To begin, I want to acknowledge that IRS is in the process of planning and implementing a major modernization, key parts of which were mandated by Congress in the IRS Restructuring and Reform Act passed last year. I emphasize this because, as I will explain, modernization will impact Congress' ability to use IRS' budget as a tool for oversight.

My statement makes four main points about IRS' budget request which are summarized in bullets beginning at the bottom of page 1 of my full statement.

First, IRS is requesting a little over \$8 billion and 98,000 full-time equivalent positions for FY 2000—virtually the same as its proposed operating level for this year. Although the overall budget request is unchanged, there is some increases and decreases within it. For example, the budget request includes \$197 million for organizational modernization, implementation of the IRS Restructuring and Reform Act, and customer service training.

We recognize that these are critical initiatives. However, we are unable to comment on the reasonableness of the requested funding because IRS is still developing its modernization plans.

The budget proposes less funding for information systems, but that does not include \$288 million the IRS plans to spend in FY 2000 out of the Information Technology Investment Account, which holds funds appropriated in past years.

My second budget point is about the implications of IRS' budget format for congressional oversight. The budget format understandably reflects the current IRS, not the modernized IRS. For exam-

ple, the proposed budget does not separately identify funding for the newly independent Office of the Taxpayer Advocate. Nor does it include two important performance measures, voluntary compliance and taxpayer compliance burden, that have yet to be developed. Nor does it sort out the IRS resources actually devoted to compliance and assistance, or the impact of diverting compliance resources to assistance.

While it is understandable that the budget does not yet reflect the modernized IRS, because modernization is still being planned, this will complicate congressional oversight. One interim solution would be for IRS to include more information in the narrative part of the budget.

My third point is a budgetary status report on IRS' 5-year effort to make its information systems year 2000 or Y2K compliant. The current estimate of total cost for the 5 years is \$1.3 billion. That's about \$345 million higher than its estimates from a year ago. The increased cost is due primarily to changes in business requirements for major system replacement projects, and to a decision to upgrade or replace some additional computer hardware and software. For FY 2000, IRS is requesting \$250 million for its Y2K efforts.

My last budget point is on IRS' request for information systems. The FY 2000 request is for about \$1.5 billion, including the above \$250 million for Y2K. This proposed spending is consistent with our prior recommendations and congressional limitations on new systems investment by IRS. This money is for FY 2000.

IRS has also requested some money for FY 2001 for information systems. This advance FY 2001 appropriation request is for \$325 million. We do not believe that IRS has adequately justified that request in accordance with Federal technology investment requirements. Thus, Congress should consider either not funding the request, or restricting obligation of the funds until IRS develops the requisite cost analysis to justify the amount requested.

I would also like to briefly comment on the current 1999 filing season.

The filing season is not over, but preliminary data show that the accessibility and quality of IRS' phone service has deteriorated considerably compared to last year, although accessibility has improved in recent weeks.

The data also shows the number of tax returns filed electronically is continuing to increase, although fewer are being filed by phone. Many taxpayers are making mistakes with respect to the new child tax credit, and new systems for processing returns and remittances have been working well.

Mr. Chairman, that concludes my statement, and I would be happy to answer any questions.

[The statement of Mr. White follows:]

**Statement of James R. White, Director, Tax Policy and Administration Issues, General Government Division, U.S. General Accounting Office**

**TAX ADMINISTRATION: IRS' FISCAL YEAR 2000 BUDGET REQUEST AND 1999 TAX FILING SEASON**

Mr. Chairman and Members of the Subcommittee: We are pleased to participate in the Subcommittee's inquiry into the administration's fiscal year 2000 budget request for the Internal Revenue Service (IRS) and the status of the 1999 tax filing season.



Our statement is based on (1) our review of the administration's fiscal year 2000 budget request for IRS and supporting documentation; (2) interim results of our review of the 1999 tax filing season; (3) our ongoing review of IRS' restructuring efforts; and (4) our past and ongoing audits of various IRS activities, including efforts to modernize its computer systems, make its systems Year 2000 compliant, and implement the government Performance and Results Act.

With respect to the fiscal year 2000 budget request, our statement makes the following points:

- For fiscal year 2000, the administration is requesting about \$8.2 billion and 97,862 full-time equivalent (FTE) positions for IRS—almost the same as IRS' proposed operating level for fiscal year 1999. Although the request reflects little change in the overall funding available to IRS, there are some changes in how IRS plans to use the fiscal year 2000 funds. For example, the request includes about \$197 million for three initiatives—organizational modernization, implementation of the IRS Restructuring and Reform Act of 1998 (RRA98), and customer service training.<sup>1</sup> These are critical initiatives. We cannot comment on the reasonableness of the requested funding, however, because IRS (1) is still developing plans that could affect the costs associated with organizational modernization and (2) did not provide us with sufficient detail to explain how some of the estimates were developed.

- Congressional oversight of IRS' fiscal year 2000 operations could be made more complex because (1) the fiscal year 2000 budget request is formatted in a way that may not reflect IRS' organizational structure in fiscal year 2000 and (2) many of the performance measures included in the fiscal year 2000 budget request are new and two important measures (voluntary compliance and taxpayer burden) have yet to be developed. Both of these situations are understandable, however, because IRS (1) has not finished planning for the organizational modernization and (2) is in the initial stages of a major effort to develop a more balanced set of performance measures.

- IRS' current 5-year cost estimate to make its information systems Year 2000 compliant is \$1.3 billion—about \$345 million higher than its March 1998 estimate. Changes in business requirements for one of IRS' replacement projects and a decision to upgrade or replace hardware and software for minicomputers/fileservers and personal computers account for some of the increase. For fiscal year 2000, IRS is requesting \$250 million for its Year 2000 efforts. Most of that amount has been allocated to the Century Date Change Project Office and one of IRS' Year 2000 replacement projects. About \$60 million of the \$123.4 million allocated to the Project Office covers funding requests for various activities that have not yet been approved by IRS.

- IRS is requesting \$1.46 billion for information systems in fiscal year 2000. IRS' plans for spending those funds are consistent with our prior recommendations and related congressional direction. IRS is also requesting for fiscal year 2001 an advance appropriation of \$325 million for its multi-year capital account for systems modernization. IRS has not adequately justified that request in accordance with federal information technology investment requirements. Thus, Congress should consider either not funding the request or restricting obligation of the funds until IRS develops the requisite cost analyses to justify the amount requested.

With respect to the 1999 filing season, preliminary data show that (1) the accessibility and quality of IRS' telephone service has deteriorated considerably since last year, although accessibility has improved in recent weeks; (2) the number of individual income tax returns filed electronically is continuing to increase, although fewer returns are being filed by telephone; (3) many taxpayers have made mistakes with respect to the new child tax credit; and (4) new systems for processing returns and remittances have been performing well.

#### IRS' FISCAL YEAR 2000 BUDGET REQUEST MAINTAINS STAFF AND FUNDS AT THE FISCAL YEAR 1999 LEVEL

For fiscal year 2000, the administration is requesting \$8.249 billion and 97,862 full-time equivalent (FTE) positions, including \$144 million and 2,095 FTEs to be funded outside the spending caps for the earned income tax credit compliance initiative.<sup>2</sup> As shown in appendix I, that request is virtually the same as IRS' proposed operating level for fiscal year 1999 (\$8.246 billion and 97,959 FTEs). The overall increase of \$3 million between the fiscal year 1999 operating level and the fiscal year

<sup>1</sup> Public Law 105–206, July 22, 1998.

<sup>2</sup> Fiscal Year 2000 will be the 3rd year of funding for this 5-year initiative.

2000 request is the net result of several increases and decreases, the most significant of which are:

- an increase of \$197 million for various initiatives, including organizational modernization;
- an increase of \$249 million to maintain current service levels; and
- a decrease of \$444 million in funding for IRS' information systems, which includes funding for information technology investments and IRS' efforts to make its systems Year 2000 compliant.

*The Reasonableness of Requested Funding for Initiatives Is Uncertain*

The fiscal year 2000 budget request includes \$197 million for three initiatives—\$140 million for organizational modernization, \$40 million and 500 FTEs to implement various provisions of RRA98, and \$17 million for training to enhance customer service. (See appendix II.) Although we agree that these are critical initiatives for IRS to undertake, we have no basis for determining whether the requested funding is reasonable because IRS (1) is still developing plans that could affect the amount of funding actually needed for organizational modernization and (2) did not provide specific details concerning how some of the estimates were developed.

Beginning in fiscal year 2000, IRS plans to reorganize its operations by establishing four main operating divisions to serve specific groups of taxpayers, including those with only wage and investment income, small business/self-employed individuals, large and midsize businesses, and tax exempt organizations. The administration has requested \$140 million for organizational modernization in fiscal year 2000. According to IRS, these funds are needed to cover the costs for employee buyouts, relocations, and retraining in conjunction with the reorganization. We could not assess the reasonableness of the \$140 million estimate because planning for the reorganization is ongoing. Until IRS' plans are finalized, it will be difficult to estimate such things as buyouts, relocation expenses, and training needs.

The fiscal year 2000 budget request also includes \$40 million and 500 FTEs for the implementation of various customer service provisions in RRA98. Of the \$40 million, \$27 million is being requested to implement taxpayer protection and rights provisions, such as increased notices and processing for innocent spouse relief and due process in collection actions, Spanish language taxpayer assistance, grants for low income tax payer clinics, and enhanced toll-free telephone and Internet access to IRS. The other \$13 million is earmarked for efforts designed to increase the use of electronic filing.

Another initiative included in the budget request calls for enhancing customer service through improved training. For this initiative, the administration is requesting \$17 million. According to IRS, \$13 million of this request is needed to permanently increase training funds that had been reduced during the past few years. IRS believes that its limited training funds have contributed to a deterioration in the competency of its employees, particularly frontline employees who have contact with taxpayers.

IRS did not provide detailed support to show how it developed the budget estimates for implementing the RRA98 provisions and for training. This made it difficult for us to assess whether IRS had a reasonable basis for those estimates.

While each of these three initiatives appear to be critical if IRS is to provide first-class customer service, without additional information it is unclear what level of funding would be adequate for these initiatives in fiscal year 2000.

OVERSIGHT COULD BE MORE COMPLEX WHILE IRS MODERNIZES ITS STRUCTURE

Congressional oversight of IRS' fiscal year 2000 operations could be more complex while IRS is modernizing its structure because (1) the budget format may not reflect IRS' operating structure in 2000; and (2) many performance measures presented in the fiscal year 2000 budget request are new, and two important measures—voluntary compliance and taxpayer burden—have not been developed. The absence of a voluntary compliance measure, for example, makes it difficult to assess the effects of IRS' diversion of enforcement resources to implement RRA98 and enhance customer service.

*Budget Format May Not Reflect IRS Operating Structure in Fiscal Year 2000*

The format of IRS' fiscal year 2000 budget request may not reflect IRS' organizational structure in fiscal year 2000. This is understandable given the fact that IRS has not finalized its restructuring plans. Until those plans are finalized, it would be premature for IRS to revise its budget format. At the same time, however, any significant disconnect between the existing budget structure and IRS' operating structure could make congressional oversight more complex.

The format of IRS' fiscal year 2000 budget request is consistent with the format of IRS' fiscal year 1999 budget and generally reflects IRS' current operating structure. However, starting later this year, IRS will be shifting from being geographically based in 33 districts offices to a customer-based structure built around four major groups of taxpayers—wage and investment income, small business and self employed, large and mid-size business, and tax exempt. Technology management is to be centralized, with each of the four major operating components being the business owner for systems that support it. IRS has not completed its planning for this organizational modernization and, thus, it is not yet clear how much change will actually take place in fiscal year 2000 versus years after 2000 and how those changes might affect oversight, if at all.

In conjunction with its organizational modernization, IRS is exploring plans to develop new financial and budget structures that could aid Congress in its oversight of IRS. We were told that IRS, as part of that effort, would be considering the needs of this Subcommittee and other congressional overseers. In that regard, there are two aspects of IRS' current budget structure that could hinder effective oversight. Those two aspects, which we discussed in our testimony on IRS' fiscal year 1999 budget<sup>3</sup> and which are still relevant, involve (1) the inability to determine how many FTEs and dollars IRS is devoting to enforcement versus assistance and (2) the lack of a separate budget activity for the Office of the Taxpayer Advocate.

#### *Mix Between Enforcement and Assistance is Not Clear*

Achieving IRS' mission requires a mix of enforcement and assistance. Congressional oversight would be enhanced, in our opinion, if Congress knew how IRS was allocating its resources between those two areas. That information cannot be derived from IRS' budget estimates.

For example, IRS is requesting \$991.5 million and 20,874 FTEs for the Telephone and Correspondence budget activity within the Processing, Assistance, and Management appropriation. That activity covers all non face-to-face contacts between IRS and taxpayers. Such contacts include typical forms of assistance, such as answering telephone calls and correspondence, as well as several enforcement activities, such as audits handled through correspondence and attempts to collect overdue taxes via the telephone. The budget estimates do not show how much of IRS' request for Telephone and Correspondence is for assistance versus enforcement. Similarly, despite its name, the Tax Law Enforcement appropriation is not exclusively for enforcement. The \$3.3 billion and 43,677 FTEs being requested for that appropriation include an unspecified amount of money and FTEs for various forms of assistance, including walk-in service and taxpayer education efforts. Finally, the \$144 million and 2,095 FTEs being requested for the EIC compliance initiative also involve a mix of assistance and enforcement, but, again, that mix is not apparent in IRS' budget estimates.

#### *Absence of a Separate Budget Activity for the Office of the Taxpayer Advocate*

The Office of the Taxpayer Advocate is responsible, among other things, for the resolution of taxpayer problems through the Problem Resolution Program. Because of concerns about that Office's independence, Congress included provisions in RRA98 that, among other things, authorized the National Taxpayer Advocate to appoint local advocates, evaluate and take personnel action with respect to any employee of any local advocate's office, and submit annual reports directly to the Senate Committee on Finance and the House Committee on Ways and Means. We believe that congressional oversight of the Advocate's Office and IRS' efforts to solve taxpayer problems would be further enhanced and any concerns about the Advocate Office's independence would be further mitigated if funding for that Office was separately identified in IRS' budget.

According to IRS, the fiscal year 2000 budget request includes about \$43.6 million and 628 FTEs for the Office of the Taxpayer Advocate. However, those amounts are not separately identified in IRS' budget estimates but are included within the Telephone and Correspondence budget activity in the Processing, Assistance, and Management appropriation.<sup>4</sup> According to the National Director for Budget, IRS would have had to make substantial coding changes to its financial system to set up a separate line item for the Advocate's Office in IRS' budget request. The National Direc-

<sup>3</sup>*Tax Administration: IRS' Fiscal Year 1999 Budget Request and Fiscal Year 1998 Filing Season* (GAO/T-GGD/AIMD-98-114, March 31, 1998).

<sup>4</sup>According to IRS' National Director for Budget, the Taxpayer Advocate's share of the budget will actually be much higher than the amount included in the request because IRS is in the process of transferring to the Advocate's Office funding responsibility for caseworkers who had been funded by other functions, such as Examination and Customer Service.

tor explained that it would not have been practical to start developing new financial codes for some organizational functions, such as the Advocate's Office, when many other changes may be needed later as IRS proceeds with its organizational modernization. We agree that it makes sense to make all needed changes to IRS' financial and budget structures at one time. Until a separate budget activity is established for the Advocate's Office, congressional oversight might be enhanced if the narrative part of IRS' budget estimates provided data on the amount of resources being devoted to that activity in the current year and being requested for the coming year.

*The Development of Performance Measures Is a Work in Process*

IRS is changing most of its performance measures and the way it uses measures to focus attention on priorities, assess organizational performance, and identify areas for improvement. A balanced set of performance measures is critical, not only for IRS management but also for effective oversight of IRS. As explained by IRS:

It is essential to establish appropriate quantitative performance measures for the IRS and for its major component operations. This is required by the government Performance and Results Act and is essential to the proper operation of any large organization. For this reason, an integral part of the overall modernization program for the IRS is the establishment of balanced performance measures which support and reinforce achievement of the IRS' restated mission and overall strategic goals.

IRS is designing Service wide performance measures in support of its mission and strategic goals as well as performance measures at the individual program level. In September 1998, the Commissioner announced a new mission statement for IRS. It says that the mission of IRS is to "provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all." To achieve this mission, IRS established three strategic goals—service to each taxpayer, service to all taxpayers, and productivity through a quality work environment.

To achieve the first goal—service to each taxpayer—IRS plans to make filing easier; provide first quality service to taxpayers needing help; provide prompt, professional, helpful treatment to taxpayers in cases where additional taxes may be due; and improve taxpayers' access to toll-free telephone assistance. To achieve the second goal—service to all taxpayers—IRS plans to increase fairness of compliance and overall compliance. To achieve the third goal—productivity through a quality work environment—IRS plans to increase employee job satisfaction and productivity while service improves. IRS said that it is realigning processes and activities to ensure that they support the mission of IRS and incorporate the principles of a balanced measurement system that focuses across three areas—business results, customer satisfaction, and employee satisfaction.

Identifying and defining Servicewide and program level performance measures is work in process for IRS. As shown in table III.1, IRS has defined 15 Servicewide performance measures and has one placeholder for a productivity measure that has yet to be defined. Nine of the 15 Servicewide measures are new. IRS has also defined 68 measures to gauge its performance in specific functional areas.<sup>5</sup> (See table III.2.) Of the 68 program level measures, more than half (40) are new.

Understandably, the lists of measures included with the fiscal year 2000 budget estimates are neither final nor complete because IRS is in the process of planning its organizational modernization and identifying performance measures. According to IRS' National Director for Budget, IRS will continue to revise and add other measures as it proceeds with the organizational modernization and implementation of RRA98. In that regard, IRS' list of Servicewide performance measures does not include two critical measures—voluntary compliance and taxpayer burden. Also, one existing Servicewide measure—toll-free level of access—is not, in our opinion, the most appropriate measure of IRS' performance in providing telephone service.

*IRS' Performance Measures Do Not Address Voluntary Compliance and Taxpayer Burden*

IRS' performance measures do not yet include any measures of voluntary compliance and taxpayer burden. While performance in both areas is difficult to measure, they are two critical indicators of IRS' performance and thus should be a vital part of any measurement system that IRS develops. According to IRS officials, IRS recognizes the importance of measuring these two areas of performance and plans to con-

<sup>5</sup> IRS' functional area include such activities as Submission Processing, Telephone and Correspondence, Examination, and Collection.

tinue to explore valid and reliable ways to measure them at the strategic level to gauge IRS-wide performance.

*Voluntary Compliance*—IRS' Organizational Performance Management Executive told us that IRS would be unable to measure voluntary compliance without something similar to the discontinued Taxpayer Compliance Measurement Program (TCMP). In the past, IRS used TCMP studies to assess voluntary compliance among taxpayers. Those studies involved detailed audits of valid samples of tax returns. IRS projected the results of those audits to determine the extent of voluntary compliance among various groups of taxpayers. IRS conducted its last TCMP studies on returns filed for tax years 1987 and 1988. IRS abandoned the TCMP studies due to concerns about the additional cost and burden placed on taxpayers. Since then, IRS has not considered TCMP studies to be a viable option for assessing voluntary compliance.

Additionally, the Organizational Performance Management Executive explained that the TCMP studies had other limitations. For example, the TCMP studies could not be used to gauge compliance in "real time"—either during the tax year in question or the year after the tax year in question. Also, IRS can not attribute all changes in compliance to its performance because voluntary compliance can be affected by other factors, such as the economy and geographical location.

We believe that a modified version of the TCMP studies, that reduces the burden on taxpayers, could be useful in assessing voluntary compliance. For example, IRS could (1) use smaller samples that project nationwide results, (2) sample groups of taxpayers and project the results to specific groups of taxpayers, or (3) continuously sample a small number of returns over a period of several years.

*Taxpayer Burden*—IRS discontinued a performance measure it once used to gauge taxpayer burden—a ratio that compared private sector costs to the cost for IRS to collect \$100 in "net tax" revenue.<sup>6</sup> IRS discontinued this measure because it was based on an outdated methodology and was considered to be a poor indicator of overall burden. IRS is currently working with a consultant to develop a new means to measure taxpayer burden. Additionally, results of IRS' taxpayer satisfaction surveys may provide some valuable insights on taxpayer burden.

#### *Level of Service Would Be a More Appropriate Servicewide Measure of IRS' Performance in Providing Telephone Service*

One important way that IRS helps taxpayers understand and meet their tax responsibilities is through toll-free telephone assistance. By calling IRS, taxpayers can, among other things, get answers to tax law questions, inquire about the status of their account, or order forms and publications. It is important that IRS and Congress know how well IRS provides this critical service. Toward that end, IRS has included "toll-free level of access" as one of its Servicewide performance measures. We believe, however, that toll-free level of access is not the most appropriate Servicewide measure for assessing IRS' performance in providing telephone service. The more appropriate measure, in our opinion, is "toll-free level of service."

The only difference between these two measures, and the reason we favor level of service, is the way in which abandoned calls are handled in computing the measures.<sup>7</sup> IRS computes level of access by adding the number of calls answered and the number of abandoned calls and dividing that sum by the total number of call attempts (which is the sum of calls answered, calls that are abandoned, and calls that receive a busy signal).<sup>8</sup> Level of service is computed by dividing the number of calls answered by total call attempts. Thus, in effect, level of access considers abandoned calls as successful call attempts while level of service considers them unsuccessful. Although level of access is a useful measure because it indicates the extent to which taxpayers are able to access IRS' system (i.e., not get a busy signal), it does not indicate the extent to which taxpayers are successful in actually talking to someone in IRS. For that reason, we believe that level of service is the more appropriate Servicewide measure of IRS' performance in providing telephone assistance.

#### *Impact of Diversion of Resources Is Uncertain*

IRS' budget request for fiscal year 2000 discusses the diversion of resources in fiscal year 1999 to implement various provisions of RRA98 and to provide assistance

<sup>6</sup>Net tax revenue is defined to include all revenue collected (i.e. income, employment, estate and gift, and excise taxes) less refunds.

<sup>7</sup>Abandoned calls are ones in which the taxpayer has gained access to IRS' system but subsequently decided, for unknown reasons, to hang up before an IRS assistor came on the line.

<sup>8</sup>Appendix I of IRS' Fiscal Year 2000 Congressional Justification incorrectly describes this measure as being computed by dividing calls answered by calls attempted. That is actually the way level of service is computed.

to taxpayers. There is insufficient information, however, for IRS or Congress to assess the overall impact of these diversions.

RRA98 contains various provisions that give additional protection to taxpayers (such as a relief from joint liability for innocent spouses), shift the burden of proof from taxpayers to IRS in certain circumstances, and make IRS liable for some legal fees incurred by taxpayers. IRS says that it plans to divert about 2,500 FTEs and \$200 million in fiscal year 1999 to implement these provisions. According to IRS, this diversion marks the “beginning of a continuing curtailment of some compliance activities, primarily the examination of tax returns and the collection of delinquent accounts.” In addition, IRS says that another 200 FTEs will be detailed from the Collection function to the Customer Service function in fiscal year 1999 to increase the quality of service to taxpayers through the walk-in program. Other diversions are possible as IRS attempts to improve the quality of its telephone service, which we discuss later.

Although IRS has made statements in the past about the potential impact of these resource diversions on enforcement revenue, its current position is that the monetary effect of such diversions is unknown. We agree with that position. To correctly assess the monetary effect of such diversions, IRS needs to be able to estimate not only the negative effect on enforcement revenues but also the potential positive effect on non-enforcement revenues from any improved taxpayer service resulting from the resource diversions.

It is expected, for example, that implementation of RRA98 will result in better service to taxpayers. Better taxpayer service could lead to an increase in voluntary compliance, which, in turn, could lead to increased revenues. Without a measure of voluntary compliance, as discussed earlier, there is no way for Congress, IRS, or others to assess such an impact.

#### THE 5-YEAR COST ESTIMATE FOR MAKING IRS' SYSTEMS YEAR 2000 COMPLIANT HAS INCREASED, AND SOME NEEDS FOR FISCAL YEAR 2000 ARE STILL UNCERTAIN

IRS' efforts to make its systems Year 2000 compliant represent one of the most expensive civilian agency programs.<sup>9</sup> The current 5-year cost estimate for IRS' Year 2000 efforts is \$1.3 billion—about \$345 million more than its March 1998 cost estimate. IRS estimates that if its Year 2000 efforts are unsuccessful, the adverse effects could include millions of erroneous tax notices and delayed or erroneous refunds. Accordingly, the Commissioner of Internal Revenue has designated this effort a top priority. IRS is requesting about \$250 million and 239 FTEs for its Year 2000 efforts for fiscal year 2000.<sup>10</sup> About \$34 million of the \$250 million is for a contingency fund for needs that may be identified later in calendar year 1999.

To make its information systems Year 2000 compliant, IRS was to (1) fix existing systems by modifying application software and data and upgrading hardware and system software where needed, (2) replace systems if correcting them is not cost-effective or technically feasible, and (3) retire systems that will not be needed after the year 2000. IRS' Year 2000 efforts include the following two major system replacement projects:

- The Service Center Mainframe Consolidation (SCMC) project involves consolidation of IRS' mainframe computer processing operations from 10 service centers to 2 computing centers. Specifically, SCMC was to (1) replace and/or upgrade mainframe hardware, systems software, and telecommunications networks; (2) replace about 16,000 terminals that support frontline customer service and compliance activities; and (3) replace the system that provides security functions for online taxpayer account databases with a new system called the Security and Communica-

<sup>9</sup> IRS' Year 2000 efforts are necessary because IRS' information systems were programmed to read two-digit date fields. Therefore, if unchanged, these systems would interpret 2000 as 1900, seriously jeopardizing tax processing and collection activities.

<sup>10</sup> The \$250 million is referred to as an increase in IRS' budget request because IRS' fiscal year 1999 appropriation did not specifically include funds for IRS' Year 2000 efforts. For fiscal year 1999, IRS' Year 2000 efforts were funded from a governmentwide Year 2000 fund that was established in the Omnibus Consolidated and Emergency Supplemental Appropriations Act for Fiscal Year 1999 (P.L. 105-277). This Act provided \$2.25 billion in emergency funding for Year 2000 computer conversion activities for nondefense activities. The Director of the Office of Management and Budget (OMB) is responsible for allocating these funds. As of February 12, 1999, OMB had released \$1.56 billion; \$690 million remains available for emerging requirements. IRS received \$483.3 million from the fund, of which \$358.3 million is to be used for Year 2000 activities. According to the Department of the Treasury budget documents, Congress earmarked the remaining \$125 million for other information systems investments that were initially included in IRS' fiscal year 1999 budget request.

tions System. Replacement of the terminals and implementation of the Security and Communications System are critical to IRS' achieving Year 2000 compliance.

- The Integrated Submission and Remittance Processing System (ISRP) is to replace IRS' two primary tax return and remittance input processing systems (the Distributed Input Processing System and the Remittance Processing System) with a single system that is to be Year 2000 compliant.

IRS established a goal to complete most of its Year 2000 work by January 31, 1999, to help ensure that it would (1) have a Year 2000 compliant environment implemented for the 1999 filing season and (2) provide time for resolving any problems that surfaced during the 1999 filing season and its Year 2000 end-to-end testing.

For fiscal year 2000, IRS is requesting (1) \$123.4 million for the activities of the Century Date Change (CDC) Project Office, which oversees the conversion and testing of changes made to existing systems; (2) \$100.6 million for SCMC; and (3) \$26.4 million for ISRP.

#### *5-Year Cost Estimate Increased*

The 5-year cost estimate for IRS' Year 2000 efforts increased by \$345.2 million between March 1998 and March 1999. In March 1998, the 5-year cost estimate for fiscal years 1997 through 2001 was about \$1 billion; IRS' current cost estimate is \$1.35 billion. Table 1 shows that the activities under the purview of the CDC Project Office and SCMC account for most of the increase.

Table 1.—5-Year Cost Comparison  
[In Millions]

Spending category	Fiscal years 1997–2001 (March 1998 estimate)	Fiscal years 1997–2001 (March 1999 estimate)	Difference
CDC Project Office .....	\$572.0	\$701.4	\$129.4
SCMC .....	332.2	499.8	167.6
ISRP .....	101.7 <sup>a</sup>	149.9	48.2
Total .....	\$1,005.9	\$1,351.1	\$345.2

<sup>a</sup> Does not include estimates for fiscal years 2000 and 2001. IRS budget documents indicate that these estimates were identified in April 1998. If these amounts are included, the ISRP cost estimate is \$146.3 million—only \$3.6 million less than the current estimate.

Source: IRS' Year 2000 cost summaries for fiscal years 1997–2001.

#### *CDC Project Office*

The CDC Project Office is responsible for (1) overseeing efforts to fix over 60 million lines of application software, (2) ensuring that hardware and systems software are compliant, and (3) overseeing the Year 2000 testing of IRS' information systems. As shown in table 1, IRS' 5-year cost estimate for CDC increased by \$129.4 million between March 1998 and March 1999. Most of the increase—\$99 million—is for fiscal year 1999.

We had difficulty identifying which aspects of the CDC Project Office budget accounted for all of the \$99 million increase because at the time IRS officials developed the March 1998 estimate they were still refining their Year 2000 needs. At that time, IRS had allocated about \$50 million to a contingency fund that was to become available for needs as they emerged. According to IRS' officials, for those needs that were defined as of March 1998, the largest cost increases are for certain contractor services and for computer hardware and software for IRS' personal computers and minicomputers/file servers.

As we noted in our June 1998 report on IRS' Year 2000 efforts, IRS placed priority on assessing and fixing its mainframe computers, which encompass most of IRS' tax processing systems.<sup>11</sup> Accordingly, the needs for IRS' minicomputers/file servers and personal computers were less defined at that point in time. For example, since developing the March 1998 estimate, IRS has decided to replace about 35,000 personal computers and the associated systems and commercial off-the-shelf software. As part of this replacement effort, IRS plans to reduce the number of commercial software and hardware products for personal computers in its inventory from about 4,000 to 60 core standard products.

Table 2 shows the CDC Project Office's spending categories and associated dollar amounts for fiscal year 1999 as of February 23, 1999.

<sup>11</sup> IRS' Year 2000 Efforts: Business Continuity and Contingency Planning Needed for Potential Year 2000 Failures (GAO/GGD-98-138, June 15, 1998).

Table 2.—CDC Project Office Spending Categories and Associated Dollar Amounts for Fiscal Year 1999

Spending category	Amount (in millions)
Personal computers .....	\$51.0
End-to-end testing <sup>a</sup> .....	48.2
Labor and discretionary .....	38.3
Program inventory and management .....	23.2
Applications and development .....	19.6
Minicomputers/file servers .....	16.7
Telecommunications .....	14.0
Noninformation technology .....	9.2
Contingency fund .....	8.8
Independent verification and validation <sup>b</sup> .....	8.8
Mainframe computers .....	1.1
<b>Total</b> .....	<b>\$239.0<sup>c</sup></b>

<sup>a</sup>The end-to-end test is to verify that a defined set of interrelated systems, which collectively support a business function, interoperate as intended in an operational environment. The test is to have two parts—the first part is scheduled from April to July 1999; the second part is scheduled from October to December 1999.

<sup>b</sup>Provides for an organization that is technically, managerially, and financially independent of the systems developers to assess, among other things, whether a system meets the user's requirements.

<sup>c</sup>Total does not add due to rounding.

Source: CDC budget data.

We cannot comment on the adequacy of the amounts that IRS has allocated to each of these categories. However, as we would have expected, IRS has allocated large portions of its budget to those major Year 2000 activities that are to be completed in fiscal year 1999—the replacement effort for its personal computers and its end-to-end testing activities.

To help ensure that agencies have sufficient funds for Year 2000 activities, OMB has authority to release funds from the government-wide Year 2000 fund. OMB notified agencies to request funding for unforeseen requirements as they emerge. Accordingly, in March 1999, after allocating the \$8.8 million in its contingency fund, IRS requested an additional \$35 million from the OMB Year 2000 fund to cover the net unfunded needs for fiscal year 1999. As of March 1999, OMB had approved \$22.3 million.<sup>12</sup>

IRS' fiscal year 2000 budget request includes \$123.4 million for the CDC Project Office. According to CDC Project Office budget documents, as of March 31, 1999, about \$29 million of the \$123.4 million has been allocated, primarily for CDC Project Office labor and discretionary costs. The CDC Project Office has received funding requests for about \$60 million which are still subject to approval, leaving a contingency amount of about \$34 million. IRS officials said that the contingency funds are to be used for needs that may be identified through (1) end-to-end testing, (2) risk management activities,<sup>13</sup> (3) Year 2000 contingency plans for IRS' core business processes,<sup>14</sup> and (4) an independent review of IRS' application software and commercial off-the-shelf software Year 2000 changes.

#### SCMC

SCMC cost increases account for \$167.6 million of the \$345.2 million increase in the 5-year Year 2000 cost estimate. As shown in table 3, IRS' March 1998 cost esti-

<sup>12</sup>IRS requested funds for several activities such as contingency planning, telecommunications, minicomputers/file servers, and independent verification and validation. OMB approved funding for most of the areas, but reduced the amount for some areas. According to IRS officials, OMB approved funding for those areas in which IRS had demonstrated an actual need and not for anticipated needs. For example, an anticipated need would include any fixes that might be needed as a result of end-to-end testing.

<sup>13</sup>IRS' CDC Project Office outlined a risk management process that is to, among other things, (1) identify risks to the successful completion of Year 2000 goals, (2) coordinate the development of risk mitigation strategies, and (3) oversee the execution of these strategies.

<sup>14</sup>In our June 15, 1998, report, we said that IRS' Year 2000 contingency planning efforts fell short of meeting the guidelines included in our Year 2000 Business Continuity and Contingency Planning Guide. Accordingly, we recommended that IRS take steps to broaden its contingency planning efforts to help ensure that it had adequately assessed the vulnerabilities of its core business processes to potential Year 2000 induced failures. In response to our recommendations, IRS determined that it needed to develop 37 contingency plans to address various Year 2000 failure scenarios for its core business processes. IRS officials told us that 26 plans were done as of March 31, 1999; the remaining 11 plans are to be completed by May 31, 1999.



mate for SMC was \$332.2 million, compared to its current cost estimate of \$499.8 million.

Table 3.—Comparison of March 1998 and March 1999 SMC 5-Year Cost Estimates

Year of estimate <sup>a</sup>	FY 1997 actual	FY 1998 <sup>b</sup>	FY 1999	FY 2000	FY 2001	Total
March 1998 estimate .....	43.8	167.3	76.0	38.4	6.7	\$332.2 <sup>c</sup>
March 1999 estimate .....	43.8	168.3	111.6	97.3	78.8	\$499.8
Difference .....	0	1.0	35.6	58.9	72.1	\$167.6

<sup>a</sup> Estimate includes only contractor costs, except where noted. According to IRS officials, there are \$64 million in additional costs excluded from the estimates. As of March 1999, these costs include (1) additional IRS staffing costs of \$32 million, (2) \$20 million for maintenance costs in the seven service centers that have not yet had their tax processing activities moved to the computing centers, and (3) \$12 million in relocation and training costs for fiscal years 1999, 2000, and 2001.

<sup>b</sup> According to SMC officials, the estimates for fiscal year 1998 also include relocation, training, and IRS staffing costs.

<sup>c</sup> In March 1998, IRS' cost estimate for the Year 2000 portions of SMC was \$265 million. IRS no longer reports SMC Year 2000 costs.

Source: SMC expenditure and budget documents.

When we testified in March 1998, we said that two of the factors that had the potential to increase SMC costs were pending expanded business requirements and schedule delays. According to IRS officials, those two factors together with a decision to upgrade one of the tax processing systems, ultimately contributed to cost increases.

According to IRS officials, IRS' fiscal year 2000 budget request of \$100.6 million<sup>15</sup> for SMC reflects much of the costs associated with implementing expanded requirements and the contractor costs, staff relocation costs, and training costs for moving the tax processing activities of five service centers in fiscal year 2000. According to SMC officials, cost estimates for fiscal years 2000 and 2001 could decrease because (1) they believe the contractor's cost estimates may be overstated and (2) some SMC activities may be funded from IRS' Operations and Maintenance budget activity as systems are fully implemented.

According to SMC officials, expanded business requirements for disaster recovery<sup>16</sup> and a decision to upgrade the hardware and software for one of its tax processing systems<sup>17</sup> account for the vast majority of the \$167.6 million increase in the 5-year cost estimate for SMC. For disaster recovery, IRS plans to obtain contractor services and purchase hardware, software, and related telecommunications for its tax processing mainframe computers and telecommunications networks. SMC officials said that the tax processing system upgrade is to (1) increase production capacity and disaster recovery capabilities, (2) provide the necessary systems architecture for IRS' planned modernization blueprint, and (3) provide substantial savings by reducing the hardware, software, and maintenance costs associated with the existing system.

According to SMC officials, the need to have contractor staff on board longer than anticipated to accommodate schedule delays accounts for some of the \$167.6 million cost increase. Specifically, in March 1999, IRS decided to delay moving the tax processing activities of five service centers, instead of completing these moves in 1999.<sup>18</sup>

<sup>15</sup> This \$100.6 million includes \$3.3 million in relocation and training costs that is not included in the March 1999 estimate for fiscal year 2000 shown in table 3.

<sup>16</sup> Disaster recovery refers to the procedures or plans for responding to the loss of an information system due to flood, fire, or computer virus. Under the original SMC disaster recovery plan, in the event of a disaster, 70 percent of the computing center's processing capability was to be restored in 36 hours. Under the expanded requirements, 100 percent of the processing capability is to be restored in 6 hours.

<sup>17</sup> This tax processing system encompasses IRS' automated collection function and the print capabilities for notices to taxpayers.

<sup>18</sup> This decision represents the second significant schedule change for SMC. Originally, IRS had planned to have the tax processing activities of the 10 service centers moved to the computing centers by the end of calendar year 1998. In May 1998, IRS revised the schedule and established two new schedules—one for the Year 2000 portion of SMC and another for the tax processing activities. The Year 2000 portion was to be completed by December 31, 1998. The schedule for tax processing activities called for moving the activities of five service centers by 1998 and the remaining five service centers in calendar year 1999. As of January 31, 1999, IRS had completed the Year 2000 portion of SMC and moved the tax processing activities of three service centers. In March 1999, IRS revised the schedule for moving the tax processing activities. Under the revised schedule, two additional moves are to occur in calendar year 1999, four in calendar year 2000, and one in early January 2001.

IRS officials cited several reasons for changing the SCMC schedule. Specifically, IRS' business organizations had limited involvement in SCMC during its early stages. As their involvement increased, they expressed concern about the ambitious schedule and helped identify certain critical success factors that needed to be addressed for SCMC to be successful. Some of these critical success factors include (1) fully implementing the automated processes associated with the consolidations before the service centers' tax processing activities were moved to the computing centers, (2) providing adequate numbers and types of staff in the service centers and computing centers, and (3) developing new business procedures for operating under consolidation. Also, SCMC officials said that the original schedule did not acknowledge that new issues might surface during each move because of operational differences among the service centers. According to IRS officials, the revised schedule provides additional time for addressing these issues.

#### INFORMATION TECHNOLOGY BUDGET: OBSERVATIONS AND SUGGESTIONS

Beginning in 1995, we reported on serious and pervasive information technology (IT) management and technical weaknesses. Since then, we have monitored IRS' progress in implementing our recommendations to correct these weaknesses and have reviewed IRS' annual budget requests to ensure that they are consistent with IRS' modernization capability and are otherwise adequately justified.

IRS' IT budget request for fiscal year 2000 includes \$1.46 billion and 7,399 FTEs to fund such things as operation and maintenance of existing systems, activities to make IRS' systems Year 2000 compliant, correction of IT management weaknesses, and development of systems to sustain IRS operations until IRS is ready to modernize. These funding categories for fiscal year 2000 are consistent with our prior recommendations and related congressional direction concerning IT spending.

In addition to the \$1.46 billion, IRS is requesting for fiscal year 2001 an advance appropriation of \$325 million for IRS' multiyear capital account for systems modernization, referred to as the "Information Technology Investments Account" (ITIA). However, IRS has not adequately justified this ITIA request because IRS has not yet developed its modernization strategic plan and supporting cost-benefit analyses for proposed system investments. Accordingly, we suggest that Congress consider either denying (i.e., not funding) the \$325 million advance request or restricting its obligation until IRS develops the requisite cost analyses to justify the amount requested, which IRS plans to do by September 30, 1999.

#### *IRS Acting to Correct IT Management and Technical Weaknesses*

In July 1995, we reported on serious management and technical weaknesses with IRS' modernization and made over a dozen recommendations to help IRS build the capability necessary to successfully modernize its systems.<sup>19</sup> In June 1996, we reported that IRS had made progress in implementing our recommendations.<sup>20</sup> However, to minimize the risk of IRS investing in systems before the recommendations were fully implemented, we suggested that Congress limit IRS' IT spending to certain cost-effective categories. These spending categories were those that (1) support ongoing operations and maintenance; (2) correct pervasive management and technical weaknesses, such as a lack of requisite systems life cycle discipline; (3) are small, represent low technical risk, and can be delivered in a relatively short timeframe; or (4) involve deploying already developed systems that have been fully tested, are not premature given the lack of a complete systems architecture, and produce a proven, verifiable business value. The act providing IRS' fiscal year 1997 appropriations<sup>21</sup> and the related conference report limited IRS' IT spending to efforts consistent with these categories.

In 1997, IRS continued to address our recommendations. For example, in May 1997, IRS issued its modernization blueprint. We briefed IRS appropriations and authorizing Committees on the results of our assessment of IRS' modernization blueprint in September 1997. In those briefings and in a subsequent report, we concluded that the modernization blueprint was a good first step that provided a solid foundation from which to define the level of detail and precision needed to effectively and efficiently build a modernized system of interrelated systems.<sup>22</sup> However,

<sup>19</sup> *Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected If Modernization Is To Succeed* (GAO/AIMD-95-156, July 26, 1995).

<sup>20</sup> *Tax Systems Modernization: Actions Underway But IRS Has Not Yet Corrected Management and Technical Weaknesses* (GAO/AIMD-96-106, June 7, 1996).

<sup>21</sup> Public Law 104-208, September 30, 1996.

<sup>22</sup> *Tax Systems Modernization: Blueprint Is a Good Start But Not Yet Sufficiently Complete to Build or Acquire Systems* (GAO/AIMD/GGD-98-54, Feb. 24, 1998).

we also noted that the blueprint was not yet complete and did not provide enough detail for building and acquiring new systems. As a result, the conference report accompanying IRS' fiscal year 1998 appropriations act again limited IRS' fiscal year spending to efforts that were consistent with the aforementioned spending categories. IRS' fiscal year 1999 appropriation act and conference report continued these spending limitations.<sup>23</sup>

In its budget requests for fiscal years 1998 and 1999, IRS requested over \$1 billion for ITIA. In our testimonies before this Subcommittee on these requests, we questioned the justification for these funds because (1) all or major parts of the amounts being requested were not based on analytical data or derived using formal cost estimating techniques, as required by OMB, and (2) IRS had not yet developed the capability to modernize.<sup>24</sup> Subsequently, Congress provided \$506 million for the account. Specifically, it appropriated \$325 million in fiscal year 1998, of which \$30 million it rescinded in May 1998 for urgent Year 2000 century date change requirements. Congress also provided \$211 million in fiscal year 1999. In providing these sums, Congress prohibited their obligation until IRS and the Department of the Treasury submitted to Congress for approval an expenditure plan that (1) implements IRS' modernization blueprint; (2) meets OMB investment guidelines; (3) is reviewed and approved by OMB and Treasury's IRS Management Board and is reviewed by us; (4) meets requirements of IRS' life cycle program; and (5) is in compliance with acquisition rules, requirements, guidelines, and systems acquisition management practices of the Federal Government.

In December 1998, IRS awarded its Prime Systems Integration Services Contract (PRIME) for systems modernization. IRS is working with the PRIME and other support contractors to develop a strategic business systems plan and complete the modernization blueprint, as we recommended, and to account for (1) changes in system requirements and priorities caused by IRS' organizational modernization and (2) changes to accommodate new technology and to implement RRA98 requirements. IRS is also working with the PRIME to establish disciplined life cycle management processes and structures, including mature software development and acquisition capabilities, before IRS begins building modernized systems. By June 30, 1999, IRS plans to have these processes and structures in place and have the necessary approvals to begin using ITIA funds to modernize systems. By September 30, 1999, IRS also plans to have its strategic business systems plan for the entire modernization, which is to identify the systems to be modernized over the next 5 years, their estimated costs, business case justification, the sequence in which they will be developed and deployed, and the architecture standards governing their development.

*Fiscal Year 2000 Information Systems Budget Request Is in Line With GAO and Congressional Spending Categories*

IRS' fiscal year 2000 request of \$1.46 billion for information systems appears consistent with the aforementioned spending categories. Specifically, 78 percent of the request, or \$1.14 billion, is to (1) operate and maintain information systems that support tax administration, (2) consolidate mainframe computing from 10 centers to 2, and (3) restructure the information systems organization. Seventeen percent of the request, or \$250 million, is for Year 2000 conversion activities. The remaining 5 percent, or \$66 million, is for initiatives to correct IT management weaknesses or to develop systems to sustain IRS operations until it implements modernized systems. For example, funding from this activity is to be used to complete and implement the modernization blueprint, including establishing system life cycle management processes.

*IRS Has Not Adequately Justified Its Fiscal Year 2001 ITIA Request*

Key provisions of the Clinger-Cohen Act, the government Performance and Results Act, and OMB Circular No. A-11 and supporting memoranda, require that, before requesting multiyear funding for capital asset acquisitions, agencies develop accurate, complete cost data and perform thorough analyses to justify the business need for the investment. For example, agencies must show that investments (1) support a critical agency mission; (2) are justified by life cycle cost-benefit analyses; and (3) have cost, schedule, and performance goals.

IRS has not performed the requisite analyses to justify its fiscal year 2001 investment account request of \$325 million because the information it needs to prepare such analyses will not be available until IRS completes its strategic business planning in September 1999. Consequently, IRS was unable to base its budget request

<sup>23</sup> Public Law 105-277, October 21, 1998.

<sup>24</sup> GAO/T-GGD/AIMD-98-114 and *Tax Administration: IRS' Fiscal Year 1997 Spending, 1997 Filing Season, and Fiscal Year 1998 Budget Request* (GAO/T-GGD/AIMD-97-66, Mar. 18, 1997).

on a clear and complete definition of fiscal year 2001 IT investments and did not justify these investments with cost-benefit analyses. Instead, IRS officials told us that they needed to develop an estimate for the fiscal year 2000 budget process in order to ensure that funds would be available for modernization in fiscal year 2001. These officials stated that if they did not have a budgetary “placeholder” for modernization, IRS faced the possibility of a funding shortfall in fiscal year 2001 when IRS plans to be building modernized systems. Consequently, IRS developed its budget request using (1) cost estimates from its March 1998 PRIME request for proposal (RFP) and (2) a cost estimate that was documented following our inquiries and using what IRS termed “rough order of magnitude” cost estimating processes. However, these estimates have shortcomings. First, IRS officials acknowledged that the RFP cost estimates are out-of-date and are for IT projects underway now and not planned for fiscal year 2001. Second, the “rough order of magnitude” estimate lacked verifiable analysis and supporting data. Finally, neither estimate was based on a specified set of fiscal year 2001 IT investments because these investments have yet to be defined.

*Matter for Consideration by the Congress*

We support IRS’ efforts to first strengthen its modernization capability and then acquire modernized systems. However, IRS’ fiscal year 2001 request for ITIA funds is not justified in accordance with Federal IT investment requirements. Accordingly, we suggest that Congress consider either denying (i.e., not funding) the \$325 million advance request or restricting its obligation until IRS develops the requisite cost analyses to justify the amount requested, which IRS plans to do by September 1999. Neither of these congressional actions should impact fiscal year 1999 and 2000 modernization efforts because the ITIA has enough funds to cover IRS’ proposed spending in both years. Specifically, of the \$506 million in the ITIA, IRS plans to spend about \$361 million during fiscal years 1999 and 2000—\$79 million and \$282 million, respectively—which will leave \$145 million for fiscal year 2001.

PRELIMINARY DATA ON THE 1999 FILING SEASON SHOW MIXED RESULTS

At the request of this Subcommittee, we are reviewing IRS’ performance during the 1999 tax filing season. Our preliminary work has shown some mixed results. Specifically, (1) taxpayers have experienced a significant decline in IRS’ telephone service, although service has improved in recent weeks; (2) the number of individual income tax returns filed electronically has continued to increase, although the number filed over the telephone has decreased; (3) there appears to be a significant amount of confusion among taxpayers with respect to the new child tax credit; and (4) new computer systems for processing returns and remittances appear to be performing well.

*Significant Decline in Telephone Service*

According to IRS’ data, taxpayers who called IRS with tax questions during the first few weeks of the 1999 filing season had considerable difficulty reaching IRS on the telephone and, once they did reach IRS, getting an accurate answer to their questions. Although that situation has improved in recent weeks, IRS’ performance overall has declined significantly compared to its level at the same point in time last year.

*Ability of Taxpayers to Reach IRS on the Telephone has Worsened Since Last Year*

Over the last few years, there has been a steady increase in the ability of taxpayers to reach IRS by telephone. This year, however, there have been serious problems. As shown in table 4, IRS data for the first 3 months of this filing season compared to the same period last year show a significant decline in IRS’ performance.<sup>25</sup>

Table 4.—Toll-Free Telephone Level of Access and Level of Service for the First 3 months of the 1999 and 1998 Filing Seasons

[in Millions]

	1999	1998
(a) Calls answered .....	27.9	29.6

<sup>25</sup> In reporting telephone data, IRS combines data on six of its toll-free telephone lines—tax law assistance, Earned Income Credit/refund inquiry, account inquiry, forms ordering, Automated Collection System, and the fraud hotline.

Table 4.—Toll-Free Telephone Level of Access and Level of Service for the First 3 months of the 1999 and 1998 Filing Seasons—Continued  
[in Millions]

	1999	1998
(b) Calls abandoned .....	7.3	6.5
(c) Subtotal—Calls that got into IRS' system .....	35.2	36.1
(d) Busy signals .....	16.9	3.5
(e) Total call attempts .....	52.1	39.6
Level of access <sup>a</sup> .....	68%	91%
Level of service <sup>b</sup> .....	54%	75%
Percent of calls that received busy signals <sup>c</sup> .....	32%	9%
Percent of calls that got into IRS' system but were abandoned <sup>d</sup> .....	21%	18%

Note: Data are for January 1 through March 27, 1999, and January 1 through March 28, 1998.

<sup>a</sup>Level of access is the sum of the number of calls answered plus the number of calls abandoned divided by the total call attempts—computed in this table by dividing row (c) by row (e).

<sup>b</sup>Level of service is the number of calls answered divided by the total call attempts—computed in this table by dividing row (a) by row (e).

<sup>c</sup>Computed in this table by dividing row (d) by row (e).

<sup>d</sup>Computed in this table by dividing row (b) by row (c).

Source: GAO analysis of data in IRS' Weekly Customer Service Report.

The significant declines in level of access (from 91 percent to 68 percent) and level of service (from 75 percent to 54 percent) come at a time when IRS, in an attempt to improve service, extended its operating hours to 24 hours a day, 7 days a week.

Cognizant IRS officials have mentioned several factors that they believe contributed to the declines in telephone access and service. One factor was IRS' decision to discontinue the use of a procedure that it had used in 1997 and 1998 to handle calls involving complex tax topics. Under that procedure, callers with questions in certain complex areas of the tax law, such as self-employment income and sale of a residence, were automatically connected to a voice messaging system. They were instructed to leave their name, address, telephone number, and the best time for IRS to call them back. Within 2 to 3 business days, an IRS employee knowledgeable in that area of the tax law was to return the taxpayer's call. During our review of the 1997 filing season, IRS told us that it decided to use this procedure after a study showed that calls dealing with complex topics involved 20-to 30-minute telephone conversations and that an assistor could answer about 5 simpler calls in that same amount of time.

According to cognizant officials, IRS decided to discontinue the use of voice messaging for complex topics because they expected to have sufficient staff available in 1999 to allow all calls to be directed to "live" assistants. There was also some concern that IRS was not providing the best possible service when it asked taxpayers to leave a message and wait a few days for a return call. Thus, IRS started this filing season by attempting to answer all taxpayer calls with live assistants.

- Other contributing factors mentioned by IRS officials included
- unanticipated staffing problems associated with the expansion to 24 hours-a-day, 7 days-a-week service;
- startup issues associated with IRS' new call routing system; and
- the lack of reliable data on accessibility during the first weeks of the filing season.

IRS has taken steps to address these contributing factors. For example, during the week of February 15, 1999, IRS reestablished the use of the messaging system for questions involving certain tax law topics. IRS' actions appear to have had a positive effect. In that regard, IRS' data show that telephone accessibility and service have improved in recent weeks. For example, IRS data on calls received during the week of March 21 through 27, 1999, showed an 83 percent level of access and a 66 percent level of service during that week—significantly better than the cumulative percentages shown in table 4.<sup>26</sup>

#### *The Accuracy of IRS' Answers to Tax Law Questions Has Also Declined*

IRS data show that taxpayers are more likely to receive inaccurate responses to their tax law questions this year compared to last. IRS checks the quality of its telephone service by monitoring a sample of telephone calls. IRS' monitoring during the

<sup>26</sup>For the same week in 1998, IRS reported a 91 percent level of access and a 72 percent level of service.

period October 1, 1998, through February 28, 1999, showed that the accuracy rate had dropped 11 percentage points (from 80 percent to 69 percent) compared to the same time period a year ago. Although still well behind last year, the 69 percent accuracy rate as of the end of February 1999 is better than the 66-percent rate that IRS reported as of the end of January 1999.

According to a cognizant IRS official, the decline in quality compared to 1998 can be attributed to many of the same factors that contributed to the decline in telephone accessibility. For example, the decision to stop using voice messaging required customer service representatives to handle complex topics that they were not responsible for last year.

*Use of Electronic Filing Continues an Upward Trend*

As noted in our report on the 1998 filing season, the number of returns filed electronically increased about 28 percent between 1996 and 1997 and about 28 percent again in 1998.<sup>27</sup> According to IRS data, as shown in table 5, that growth is continuing, although at a reduced rate.

Table 5.—Individual Income Tax Returns Received by IRS

[In Thousands]

Filing type	1/1/97 to 4/04/97	1/1/98 to 4/03/98	Percent change: 1997 to 1998	1/1/99 to 4/02/99	Percent change: 1998 to 1999
Paper:..					
Traditional .....	45,306	42,470	-6.3	41,538	-2.2
1040PC <sup>a</sup> .....	4,488	3,534	-21.3	3,084	-12.7
Subtotal .....	49,794	46,004	-7.6	44,622	-3.0
Electronic:..					
Traditional <sup>b</sup> .....	13,007	16,306	25.4	20,167	23.7
TeleFile <sup>c</sup> .....	4,072	5,116	25.6	4,829	-5.6
Subtotal .....	17,079	21,422	25.4	24,996	16.7
Total .....	66,873	67,426	0.8	69,618	3.3

<sup>a</sup> Under the Form 1040PC method of filing, a taxpayer or tax return preparer uses personal computer software that produces a paper tax return in an answer-sheet format. The Form 1040PC shows the tax return line number and the data for that line number. Only numbers for those lines on which the taxpayer has made an entry are included on the Form 1040PC.

<sup>b</sup> Traditional electronic filing involves the transmission of returns over communication lines through a third party, such as a tax return preparer or electronic return transmitter, to an IRS service center.

<sup>c</sup> Under TeleFile, certain taxpayers that are eligible to file a Form 1040EZ are allowed to file using a toll-free number on touch-tone telephones.

Source: IRS' Management Information System for Top Level Executives.

As table 5 shows, although there has been an overall increase in electronic filing, there has been a decrease in one form of electronic filing—TeleFile. It is unclear at this point why the use of TeleFile has declined. It is also unclear whether there are any particular factors that primarily account for the overall increase in electronic filing.

One factor that may be contributing to the increase in electronic filing this year, but which has broader implications for future years, is IRS' effort to find workable alternatives to paper signatures. Generally, taxpayers using the traditional form of electronic filing have to send IRS a paper signature form along with copies of their Forms W-2. The fact that electronic filing has not been completely paperless has been cited as a major barrier to its greater use. In that regard, IRS has been conducting tests this year directed at making electronic filing truly paperless by allowing participants to use electronic signatures and by waiving the need for participants to send their W-2s to IRS.<sup>28</sup> In one test, for example, taxpayers are to choose a personal identification number to use when filing through certain tax preparers. We will be following up on the results of these tests as we continue our review of the filing season.

<sup>27</sup> *Tax Administration: IRS' 1998 Tax Filing Season* (GAO/GGD-99-21, Dec. 31, 1998).

<sup>28</sup> According to a cognizant IRS official, IRS can waive the submission of W-2s because there is no statutory requirement that these forms be attached to tax returns.

*The New Child Tax Credit Has Been the Source of Many Taxpayer Errors*

The individual income tax returns being filed this year include, for the first time, the opportunity for eligible taxpayers to claim a child tax credit. According to IRS data, of about 1.88 million error notices sent to taxpayers as of March 12, 1999, about 202,000 (almost 11 percent) involved errors with the child tax credit. Those errors generally involved taxpayers either (1) miscalculating the credit or (2) not claiming the credit even though they appear to be eligible.

With respect to the latter, taxpayers are to indicate whether a dependent is a qualifying child for purposes of the child tax credit by checking a box on the front of the Individual Income Tax Return (Form 1040 or Form 1040A). They are then to use a worksheet included in the Form 1040/1040A instructions to compute the amount of their credit, if any, and enter that amount on the back of the form.

According to data from IRS' Taxpayer Usage Study, which is a sample of filed individual income tax returns, about 36 percent of the returns filed as of March 12, 1999, included dependents that the taxpayer indicated, by a checkmark on the front page, were qualifying children for the child tax credit. However, the same data show that only about 24 percent of the returns filed as of that date claimed the credit. Thus, about one-third of the taxpayers who indicated eligibility for the credit did not claim it. This apparent discrepancy may be an indicator of the complexity of the new credit or may just reflect taxpayer oversight. Some of the discrepancy could also be explained by the possibility that taxpayers, after completing the worksheet, found that they were ineligible for the credit and, therefore, did not claim it.

Last month, IRS changed its procedure for processing returns when taxpayers do not claim a child tax credit even though they indicate on the front of the return that they have one or more dependents who qualify for the credit. Initially, IRS' procedure called for adjusting the taxpayer's return to include the credit if information on the return indicated that the taxpayer met the adjusted gross income test and certain other eligibility criteria. However, the procedure did not require verification of the qualifying child's age.<sup>29</sup>

IRS modified its procedure in March by instructing service centers to do research to determine if the child meets the age criteria before adjusting the return. If the research determines that the taxpayer qualifies for the credit, the service center is to adjust the taxpayer's return and include the credit. If the research determines that the taxpayer does not qualify for the credit, the service center is to process the return as filed (i.e., without the credit). If the research is inconclusive, the service center is to process the return as filed but notify the taxpayers that they (1) may be eligible for the credit and (2) should file an amended return to claim the credit, if they determine that they are eligible.

*Computer Systems Performing Well*

Our work to date has not identified any significant disruption of IRS' ability to process returns and issue refunds that might be indicative of computer-related problems.

IRS has made major changes this year to the computer systems it uses to process returns and remittances. One major change involved replacement of the returns processing system at all 10 service centers and replacement of the remittance processing system at 6 centers. According to an IRS spokesperson for that project and processing officials at one service center, the transition to the new systems has gone well, and workloads are being processed as intended. A second major change involves the consolidation of mainframe service center computer equipment at IRS' two computing centers in Martinsburg, WV, and Memphis, TN. So far, three service centers have undergone consolidation. According to a cognizant official at one of those centers, the consolidation has not adversely affected the center's ability to process returns.

That concludes my statement. We welcome any question that you may have.

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<sup>29</sup> A qualifying child, for purposes of this credit, is a son, daughter, adopted child, grandchild, stepchild, or foster child who (1) is claimed as a dependent, (2) is a U.S. citizen or resident alien, and (3) was under the age of 17 at the end of the tax year.

Appendix I:—IRS' Fiscal Year 2000 Budget Request Compared With Proposed Fiscal Year 1999 Operating Level

[Dollars in thousands]

Budget activity	FY 1999		FY 2000		Percent change	
	Dollars	FTEs	Dollars	FTEs	In dollars	In FTEs
Submission Processing .....	\$884,000	15,384	\$973,599	15,475	10.14	0.59
Telephone and Correspondence .....	812,651	19,650	991,456	20,874	22.00	6.23
Document Matching .....	60,683	1,555	60,395	1,555	-0.47	0.00
Inspection <sup>a</sup> .....	0	0	0	0	NA	NA
Management Services .....	563,122	6,952	615,941	6,652	9.38	-4.32
Rent and Utilities .....	664,322	135	671,144	135	1.03	0.00
Subtotal: Processing, Assistance, and Management Appropriation .....	\$2,984,778	43,676	\$3,312,535	44,691	10.98	2.32
Criminal Investigation .....	367,099	3,824	374,306	3,824	1.96	0.00
Examination .....	1,717,775	23,768	1,835,346	23,588	6.84	-0.76
Collection .....	679,385	11,195	707,411	11,095	4.13	-0.89
Employee Plans and Exempt Organizations .....	139,845	2,055	148,999	2,109	6.55	2.63
Statistics of Income .....	27,513	464	28,731	479	4.43	3.23
Chief Counsel .....	232,572	2,582	242,045	2,582	4.07	0.00
Subtotal: Tax Law Enforcement Appropriation .....	\$3,164,189	43,888	\$3,336,838	43,677	5.46	-0.48
Operations and Maintenance .....	1,166,583	8,000	1,138,814	6,976	-2.38	-12.80
Year 2000 .....	0	0	250,426	239	NA	NA
Investments .....	92,947	184	66,161	184	-28.82	0.00
Subtotal: Information Systems Appropriation .....	\$1,259,530	8,184	\$1,455,401	7,399	15.55	-9.59
Information Technology Investments <sup>b</sup> .....	\$211,000	0	0	0	NA	NA
Year 2000 Emergency Fund <sup>c</sup> (outside caps) .....	\$483,300	239	0	0	NA	NA
Earned Income Credit (outside caps) .....	143,000	1,972	\$144,000	2,095	0.70	6.24
Total .....	\$8,245,797	97,959	\$8,248,774	97,862	0.04	-0.10

<sup>a</sup>In accordance with Public Law 105-206, the IRS Inspection activity was transferred to the Treasury Inspector General for Tax Administration on January 19, 1999.

<sup>b</sup>New funding for fiscal year 2000 is not needed since IRS will use carryover balances; however, IRS is requesting an advance appropriation of \$325 million in fiscal year 2001 for funding of the Prime Systems Integration Services Contract.

<sup>c</sup>For fiscal year 1999, IRS' Year 2000 efforts were funded from a governmentwide Year 2000 fund that was established in the Omnibus Consolidated and Emergency Supplemental Appropriations Act for Fiscal Year 1999 (P.L. 105-277).

Source: IRS' February 1, 1999, budget estimates for fiscal year 2000.



## Appendix II: Comparison of IRS' Fiscal Year 1999 Proposed Operating Level and Fiscal Year 2000 Budget Request

(Dollars in thousands)

	Subtotal	Total
Fiscal year 1999 proposed operating level .....		\$8,245,797
Decreases for fiscal year 2000:		
IT investment (non-recur) .....	\$211,000	
Year 2000 emergency fund (non-recur) .....	483,300	
Absorption of mandatory non-labor costs .....	50,566	
Subtotal—decreases .....	\$744,866	
Increases for fiscal year 2000:		
Adjustments necessary to maintain current levels .....	\$299,369	
Year 2000 conversion .....	250,426	
Organizational modernization .....	140,000	
RRA98 .....	40,000	
Customer service training .....	17,000	
Increase in Earned Income Tax Credit compliance initiative .....	1,000	
Subtotal—increases .....	\$747,795	
Fiscal year 2000 budget request .....		\$8,248,726

Source: IRS' Fiscal Year 2000 Congressional Justification.

## Appendix III: IRS Performance Measures

Tables III.1 and III.2 show the Servicewide and program performance measures included in IRS' February 1, 1999, budget estimates for fiscal year 2000. IRS' performance measures will continue to evolve as IRS continues to implement its organizational modernization. Fiscal year 1999 represents a transition period for IS to introduce and baseline (gather and analyze data) the new measurement system. Performance measures with "baseline" noted in the fiscal year 1999 or fiscal year 2000 column indicate that these are new IRS measures. As shown in both tables, IRS plans to establish the baselines for most of its performance measures in fiscal year 1999.

Table III.1.—Servicewide Performance Measures With Performance Report Based on Fiscal Year 1998 Data

Servicewide performance goal	Performance measure	FY 1998	FY 1999	FY 2000
		Actual	Final plan	Proposed
Service of each taxpayer	Toll-free level of access ..	89.96% .....	80–90% .....	80–90%
	Number of calls answered, includes automated (million) <sup>a</sup> .	113.3 .....	120.3 .....	120.3
	Tax law accuracy rate for taxpayer inquiries (toll free).	93.8% .....	85% .....	85%
	Customer satisfaction—toll free.	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
	Number of taxpayers served—walk in (million) <sup>a</sup> .	10.1 .....	10.0 .....	10.0
	Customer satisfaction—walk-in.	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
	Customer satisfaction—field and office examination.	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
	Field collection quality ..	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
	Field and office examination quality.	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
	Customer satisfaction—field collection.	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
	Total net revenue collected (billions) <sup>a</sup> .	\$1,616.0 ....	\$1,725.0 .....	1,785.0
Service to all taxpayers ..	Total enforcement revenue collected (billions) <sup>a</sup> .	\$35.2 .....	\$33.3 .....	33.3

Table III.1.—Servicewide Performance Measures With Performance Report Based on Fiscal Year 1998 Data—Continued

Servicewide performance goal	Performance measure	FY 1998	FY 1999	FY 2000
		Actual	Final plan	Proposed
Productivity through a quality work environment.	Total enforcement revenue protected (billions) <sup>a</sup> .	\$7.2 .....	\$7.2 .....	7.2
	Alternative treatment revenue.	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
	Employee satisfaction (Servicewide).	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
	IRS productivity measure (placeholder).	<sup>b</sup> .....	<sup>b</sup> .....	Baseline

<sup>a</sup> Workload projections only.<sup>b</sup> Measure not applicable to this period.<sup>c</sup> To be determined.

Source: IRS' Fiscal Year 2000 Congressional Justification.

Table III.2.—Program Performance Measures With Performance Report Based on Fiscal Year 1998 Data

Performance measure	FY 1998	FY 1999	FY 2000
	Actual	Final plan	Proposed
1. Total number of individual refunds issued (millions) <sup>a</sup> .	87.9 ...	92.2 .....	94.2
2. Refund timeliness—paper (%) .....	.....	Baseline .....	<sup>c</sup>
3. Refund timeliness—e-file (%) .....	98.7%	98% .....	98%
4. Processing accuracy rate—paper filing.			
Distributed Input System .....	94.6%	94.6% .....	94.6%
Code and edit .....	96.1%	96% .....	96%
5. Processing accuracy rate—e-file ....	98.9%	99% .....	99%
6. Notice accuracy rate .....	98.4%	98.5% .....	98.5%
7. Number of individual returns filed through electronic returns originators (millions).	17.7 ...	20.9 .....	22.9
8. Number of eligible quarterly forms (Form 941) filed through TeleFile (thousands).	677.4	1,146.1 .....	1,186.0
9. Number of TeleFile returns (millions).	5.96 ...	6.6 .....	7–7.8
10. Number of primary returns processed (millions) <sup>a</sup> .	209.8	211.9 .....	213.9
11. Percent of individual returns filed electronically.	19.8%	23% .....	25%
12. Percent of dollars received electronically.	67.7%	78% .....	78%
13. Automated Collection System (ACS)—online accuracy.	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
14. ACS—Cycle timeliness .....	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
15. ACS—Customer relations .....	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
16. ACS—Overage inventory .....	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
17. Tax law accuracy rate for taxpayer inquires (toll free).	93.8%	85% .....	85%
18. Accounts accuracy rate for taxpayer inquires.	87.9%	87.9% .....	88.5%
19. Toll free timeliness .....	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
20. Toll free customer relations (tax law and accounts).	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
21. Service Center examination—overage inventory.	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
22. Service Center examination accuracy.	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
23. ACS level of service .....	<sup>b</sup> .....	Baseline .....	<sup>c</sup>

Table III.2.—Program Performance Measures With Performance Report Based on Fiscal Year 1998 Data—Continued

Performance measure	FY 1998	FY 1999	FY 2000
	Actual	Final plan	Proposed
24. Toll free—level of service .....	b .....	Baseline .....	c
25. Toll free—adherence to scheduled hours.	b .....	Baseline .....	c
26. Service Center examination—volume/mix (placeholder).	b .....	b .....	b
27. Customer satisfaction—toll free ..	b .....	Baseline .....	c
28. Customer satisfaction—ACS .....	b .....	Baseline .....	c
29. Customer satisfaction—Service Center examination.	b .....	Baseline .....	c
30. Employee satisfaction—toll free ..	b .....	Baseline .....	c
31. Employee satisfaction—ACS .....	b .....	Baseline .....	c
32. Employee satisfaction—Service Center examination.	b .....	Baseline .....	c
33. Taxpayer Advocate average processing time (days).	37.8 ...	37.8 .....	37.8
34. Taxpayer Advocate quality customer service rate.	80.8 ...	81.3 .....	81.3
35. Currency of Taxpayer Advocate inventory (days).	91.3 ...	91.8 .....	91.8
36. Field and office examination—volume/mix (placeholder).	b .....	Baseline .....	c
37. Field and office examination quality.	b .....	Baseline .....	c
38. Percent of field and office examination cases overage.	b .....	Baseline .....	c
39. Customer satisfaction—field/office examination.	b .....	Baseline .....	c
40. Employee satisfaction—field/office examination.	b .....	Baseline .....	c
41. Appeals customer satisfaction .....	b .....	Baseline .....	c
42. Appeals employee satisfaction .....	b .....	Baseline .....	c
43. Appeals nondocketed cycle time (days).	210 ...	210 .....	210
44. Field collection—volume/mix .....	b .....	Baseline .....	c
45. Field collection quality .....	b .....	Baseline .....	c
46. Percentage of field collection cases overage.	b .....	Baseline .....	c
47. Percentage of offers-in-compromise processed within 6 months.	60.5%	59.3% .....	59.3%
48. Customer satisfaction—field collection.	b .....	Baseline .....	c
49. Employee satisfaction—field collection.	b .....	Baseline .....	c
50. Employee Plans (EP) determination letter timeliness (days).	118 ...	145 .....	c
51. Exempt Organizations (EO) determination letter timeliness (days).	85 .....	85 .....	81
52. EP examination timeliness (days)	193 ...	200 .....	230
53. EO examination timeliness (days)	251 ...	259 .....	294
54. EO determination customer satisfaction.	b .....	Baseline .....	c
55. EP determination customer satisfaction.	b .....	Baseline .....	c
56. EO examination customer satisfaction.	b .....	Baseline .....	c
57. EP examination customer satisfaction.	b .....	Baseline .....	c
58. Employee satisfaction—EP/EO ...	b .....	Baseline .....	c
59. Percent of Statistics of Income projects delivered on time.	100%	90% .....	90%
60. Quality customer service rate .....	98% ...	90% .....	90%

Table III.2.—Program Performance Measures With Performance Report Based on Fiscal Year 1998 Data—Continued

Performance measure	FY 1998	FY 1999	FY 2000
	Actual	Final plan	Proposed
61. Guidance and assistance—volume/mix.	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
62. Litigation case—volume/mix .....	<sup>b</sup> .....	Baseline .....	<sup>c</sup>
63. Chief Counsel quality .....	<sup>b</sup> .....	<sup>b</sup> .....	Baseline
64. Chief Counsel customer satisfaction.	<sup>b</sup> .....	<sup>b</sup> .....	Baseline
65. Chief Counsel employee satisfaction.	<sup>b</sup> .....	<sup>b</sup> .....	Baseline
66. Master file weekend update completion times.	66.0%	85.6% .....	97.0%
67. Corporate file on-line availability to front line personnel.	99.7%	99.0% .....	99.0%
68. Integrated Data Retrieval System real time availability to front line personnel.	99.4%	99.0% .....	99.0%

<sup>a</sup> Workload projections only.<sup>b</sup> Measure not applicable to this period.<sup>c</sup> To be determined.

Source: IRS' Fiscal Year 2000 Congressional Justification.

Chairman HOUGHTON. Thank you very much.

Mr. Coyne, would you like to ask any questions?

Mr. COYNE. No questions, Mr. Chairman.

Chairman HOUGHTON. OK. Well, I would like to ask just a couple of general questions.

How do you think the IRS is performing during the current tax filing season?

Mr. WHITE. I think it was a challenging filing season for them going in, because of the number of changes they made to their information systems. I think in that respect the filing season has gone well.

Perhaps the biggest problem we have seen is the decrease in phone service, the level of service provided to taxpayers calling in, which the Commissioner discussed.

Chairman HOUGHTON. But you feel that it has picked up in the last couple of weeks?

Mr. WHITE. It has picked up in the last few weeks. It's not up to the level it was at the same time a year ago. But it has picked up.

Chairman HOUGHTON. So what do you make of that? Is that something which is a basic gap, or correctable?

Mr. WHITE. We hope it's correctable. If the Commissioner is right about some of the reasons for it, then it is correctable. And the restructuring that is being planned at IRS, and should be implemented over the next years, should also contribute to correcting that problem, as well as systems modernization at IRS.

Chairman HOUGHTON. I think it was your fourth point, that the IRS is requesting \$1.46 billion for information systems, at the bottom of page 2. Then you said that you're questioning the advanced appropriation of \$325 million for the capital account.

Mr. WHITE. Yes.

Chairman HOUGHTON. Sort of break that down a little bit, will you?

Mr. WHITE. Yes. The capital account is money that they are requesting for FY 2001, as opposed to the money they are requesting for FY 2000. Mr. Mountjoy can probably provide some more detail about the basis for our conclusion about—

Chairman HOUGHTON. Do you think it's too much money, or you don't think it's appropriate?

Mr. MOUNTJOY. I think the problem, Mr. Chairman, is that we just don't know what exactly they're going to buy with it—and the IRS acknowledges that. They haven't identified the set of investments that they're going to make yet. They're going to know that in September, but as of where we stand right now, they do not know a definitive set of investments, the systems they are going to start building at that time. That's the only reason we're questioning whether \$325 million is enough, is it too much, or maybe it's not enough at all. We just don't know at this point.

Chairman HOUGHTON. So if I were the Commissioner of IRS and I would ask you to tell me what you wanted to know, would you be able to tell them?

Mr. MOUNTJOY. I think they already know. They have a team—

Chairman HOUGHTON. What do you want to know to make you feel comfortable?

Mr. MOUNTJOY. I think we want to know, No. 1, the projects, the systems you're going to undertake, (a). And (b), I think we want to know what is the business case justification for those, and ultimately what's the cost schedule and the performance goals that you want to get out of those systems.

These are things required by normal business practice. I mean, what exactly are you going to do with these systems? It's all very clear. It's laid out in Federal IT legislation and regulations, and I think they're working toward that. They just need to get there. September 30th is the date they're trying to come forth with that.

Chairman HOUGHTON. It seems to me they have a lot of issues to wrestle with, but one is the capital budget. Do they have enough money to do the things they want to do in order to try and at least come near their goal of electronic filing? Also, even for just sort of normal operations, to have more than a 1-year budget—I mean, this is true for many departments, particularly the military.

Do you think they're handling those issues well?

Mr. MOUNTJOY. I don't think we know for sure, in terms of the electronic filing. They have a team that's working on that, a team made up of the new PRIME contractor and IRS, with some of the support contractors. It's a team working forward. They're trying to determine what it is they want to do and how that's going to fit into their overall modernization blueprint.

That was a requirement that came out of the Reform Act, and it is something they have to deal with. The fact that their original blueprint had major portions of electronic filing toward the back of the blueprint, they were going to do that later rather than sooner.

What has happened now is that that requirement has been moved up, so they need to rethink the blueprint and exactly how they're going to sequence all these different projects. So, once

again, the PRIME contractor, along with IRS folks and some support contractors, are working on a team that is going to develop exactly what do we want to do with electronic filing, and how is it going to fit in sequence with the other projects, and how much is it going to cost. They're going to try to determine this all by September.

Chairman HOUGHTON. So you feel they may have too much on their plate already?

Mr. MOUNTJOY. I wouldn't think they have too much on their plate. I think they're trying to contemplate what they can do and what they can't do, and hopefully this plan in September is going to lay all that out very clearly for us.

Chairman HOUGHTON. One final question, and this has to do with simplification of the tax law.

You know, you follow these things all the time. You're reviewing the tax return filing season and the operations and all that. Are we making strides in a meaningful way toward simplifying the system, the point being that the person we're affecting is the customer out there, the citizen. We can internally correct our cost system, we can have greater capital, involve new equipment, have greater training and all that sort of stuff. But how does it affect the customer out there?

Mr. WHITE. In terms of simplifying—

Chairman HOUGHTON. Right, simplification, ease of handling.

Mr. WHITE. In terms of simplification, from the point of view of taxpayers and the work we've done in the past on this, it shows that there are two factors that affect the difficulty that taxpayers have.

One influence, of course, is the Tax Code itself, which IRS doesn't control, and the other factor is IRS' administration of the Tax Code as it exists. I think there the point is that the restructuring of IRS is intended to improve the assistance that IRS is able to give taxpayers.

As they restructure and split themselves up into these four operating divisions that are focused on different types of taxpayers, the intent is that they will be able to provide better service to those taxpayers.

I would like to say that there are a couple of keys to this that we found in our work. One is developing a balanced set of performance measures. Those performance measures ultimately are what will create the incentives that affect the behavior of managers at IRS and the frontline staff at IRS. Without a balanced set of performance measures that balance both the compliance role and the assistance role, you may not see the kind of change in behavior that's desirable.

The other thing that I think is key here is systems modernization. Without modern information systems, they are not going to be able to make significant headway in some of the other problem areas that we have found in the past.

Chairman HOUGHTON. But you feel they are making progress in systems modernization?

Mr. WHITE. Well, it's too early to see what kind of progress has been made.

Chairman HOUGHTON. They're making no progress?

Mr. WHITE. Well, they're in the process of planning. They are taking a look, as Mr. Mountjoy said, at the blueprint. They need to look at that in light of the plans for restructuring and make sure that the blueprint for systems modernization still makes sense, given what they're trying to do on the business side, in terms of their business operations.

Chairman HOUGHTON. Thank you very much, gentlemen. We really appreciate your testimony. I look forward to seeing you again.

Now I would like to call the next panel, which is Mark Ernst, Executive vice president and chief operating officer of H&R Block; Roger Harris, President of Padgett Business Services, Athens, Georgia, and chairman of the Federal Taxation Committee, National Society of Accountants, Alexandria, Virginia; and Donna Joyner-Rodgers, president of the Rainbow Tax Service, Las Vegas, Nevada, and member of the government Relations Committee, National Association of Enrolled Agents, in Gaithersburg, Maryland.

All right. Mr. Ernst.

**STATEMENT OF MARK A. ERNST, EXECUTIVE VICE PRESIDENT  
AND CHIEF OPERATING OFFICER, H&R BLOCK, INC., KANSAS  
CITY, MISSOURI**

Mr. ERNST. Mr. Chairman and Members of the Committee, I am Mark Ernst, executive vice president and chief operating officer of H&R Block. With me today is Bob Weinberger, our vice president for government Relations.

We appreciate the opportunity to discuss the current tax filing season and the IRS' fiscal year 2000 budget request.

H&R Block is the Nation's largest tax preparation firm. At 8,900 offices throughout the United States, we handled over 15 million individual returns—1 in 7 returns received by the IRS in 1998, which is about 36,000 returns per congressional district.

We are leaders in electronic filing, originating over half of the e-filed returns that the IRS received.

We also publish "Kiplinger TaxCut" tax preparation software, which has over 1.5 million users and through which an additional half million returns will be electronically filed this year.

I would like to make several brief points.

First, a word on the IRS. The IRS has undertaken a number of impressive initiatives to improve performance, address technology problems, and strengthen customer service. There is a new energy at the agency and a flurry of activity as new leaders are recruited, missions rewritten, strategies recast, and reorganization blueprints reviewed.

The IRS has earned top marks for performance or effort in several of the areas in which we interact, especially electronic filing. Problem Solving Days, citizen advisory panels, better liaison with practitioners, and 24-hour call centers are all pluses.

No bureaucracy is without its frustration. No tax processing system as large as ours can be error-free. Every tax season brings its own challenges. And the IRS has had its share of problems, especially in technology and enforcement. But progress is being made. And Congress' emphasis on reform is beginning to pay dividends.

Second, this tax season has gone remarkably well. While not problem-free, overall IRS return processing has gone smoothly. Our volume is up 9.6 percent over last year, through March 15. Our electronic filing returns are up 21.6 percent, following last year's 26-percent increase.

Let me comment on several aspects of the season.

- On electronic filing, IRS has improved promotion and is working well with practitioners. It has a strategy to address Congress' twin goals of 80 percent of all returns e-filed by 2007 and all computer-prepared practitioner returns e-filed by 2002.

Three important points:

First, while IRS is on the right track, it may fall short of those goals. It is only projecting 33 percent of returns being e-filed by 2005. Unless more Americans overcome apprehensions and more practitioners enlist, the goal won't be met.

We recommend eight priority steps to help IRS get to the goals. Principal among them is a continuing focus on private sector co-operation and innovation. Practitioners provide over 80 percent of the e-filed returns IRS receives. The success to date of electronic filing is an example of what can be done when the public and private sectors work together to better serve taxpayers.

Second, this year we have continued to step up our own efforts. We have eliminated electronic filing fees for clients in a majority of our offices. We have offered free preparation and e-filing on our taxcut.com Web site to 24 million eligible 1040EZ filers. And 7,500 of our offices participated in a successful test using PIN authentication numbers in place of burdensome paper signature forms to achieve nearly paperless electronic filing.

And, finally, as relates to electronic filing, while IRS had a number of glitches this year, which I list, most of the problems were resolved quickly. Past problems with pre-refund examinations of earned income tax credit returns, which delayed refunds, have improved.

- On complexity, some taxpayers were especially challenged this year by the child credit and by conversions of regular IRAs to Roth IRAs.

While much complexity concentrates on business taxpayers and the quarter of taxpayers with complex financial lives and multiple sources of income, it is creeping into a growing group of middle- and low-income tax payers.

As we have in each of the past 2 years, we will submit for the record 10 of our own suggestions for simplification. We look forward to working with the Committee on simplification.

- On paid preparers, many people believe that complexity is the major reason that half of all taxpayers use tax preparers. While that certainly is important, many clients also come because of frequent changes in tax law, because of life changes—marriages, births, retirements, and so forth, to speed refunds, and for convenience. We may be capable of changing the oil in our car, for example, but prefer paying someone else to do it to allow us more time for other pursuits. And some clients have math anxiety or language difficulties that also impede their ability to prepare their own returns.



- Finally, on use of new tax provisions, the child credit has been a best seller and benefited about a third of our clients this year. But millions of low-income working families with children are ineligible. Education credits, the education IRA, and deductions of interest on student loans have all proved very popular. Less successful have been overly complex provisions for farmers and mutual fund investors who pay foreign taxes.

Finally, Mr. Chairman, on the budget, we support the IRS getting necessary funds to do its job, especially in modernizing technology and implementing the 1000-plus Tax Code changes Congress has passed in the last 2 years.

We look forward to working with you to improve our tax system. We hope lessons from this season will be learned well enough to enable smooth return processing next year, with refunds issued promptly, and the IRS continuing on the path to reform.

Thank you.

[The statement of Mark Ernst follows:]

**Statement of Mark A. Ernst, Executive Vice President and Chief Operating Officer, H&R Block, Inc., Kansas City, Missouri**

Mr. Chairman and Members of the Subcommittee: I'm Mark Ernst, Executive Vice President and Chief Operating Officer of H&R Block. Prior to joining the company last September, I was for 12 years affiliated with American Express. We appreciate the opportunity to discuss the 1999 tax filing season and the IRS budget for Fiscal Year 2000. With me is Robert Weinberger, our Vice President for Government Relations.

**ABOUT H&R BLOCK**

H&R Block, founded in 1955 and headquartered in Kansas City, is America's largest tax return preparation company. Over 120,000 individuals take our tax training courses annually. With more than 8,900 U.S. offices, we handled over 15 million individual returns in 1998—which is one in seven received by the IRS and about 36,000 per Congressional district. We are leaders in electronic filing, originating over half the practitioner e-filed returns that the IRS receives. We also offer our clients mortgages, financial planning, and investment services. We are building a national accounting practice to expand our business services. We publish Kiplinger TaxCut® tax preparation software, which has over 1.5 million users, and author the annual H&R Block Income Tax Guide. And we prepare tax returns at over 1,200 offices in Canada, Australia, and the United Kingdom.

**IRS REFORM**

Even before passage of the landmark Internal Revenue Service Restructuring and Reform Act of 1998 (RRA98), Commissioner Rossotti began a number of initiatives to improve the agency's performance, address technology problems, and improve customer service. As he has said, those are not overnight projects. But thus far, his efforts have been impressive. There is new energy at the agency and a flurry of activity as new leaders are recruited, the mission and strategies recast, reorganization blueprints reviewed, and relationships with key constituencies strengthened. The IRS has earned gold stars for performance or effort in several of the areas in which we interact, especially electronic filing, while at the same time working on Y2K, reorganizing itself, integrating 1,200 tax law changes, and modernizing antiquated computers. Problem solving days, citizens advisory panels, and 24-hour phone lines all are pluses.

No system that processes 1.2 billion tax and information returns, issues 85 million refunds, answers over 100 million assistance calls, and collects \$1.8 trillion annually—much of it in a 105-day filing season—will ever be error-free. No government bureaucracy is without frustration. Every tax filing season brings its own challenges. And the IRS has had more than its share of problems, especially in the technology and enforcement areas. But progress is being made, and Congress' emphasis on reform is beginning to pay dividends.

Let me comment on several benchmarks that may help evaluate the current filing season and then briefly comment on the IRS Fiscal Year 2000 budget request.

#### FILING SEASON BENCHMARKS

- *Volume.* Overall, the 1999 filing season has gone remarkably well. H&R Block tax preparation, through March 15, is up 9.6% over last year. Our e-filed returns are up 21.6%, following a strong season last year in which they were up 26%. Nearly 72% of our returns are filed electronically. Overall, IRS return processing has gone smoothly, but it has not been problem-free.

- *Electronic Filing.* As a pioneer in electronic return filing, H&R Block still provides over half the practitioner e-filed returns the IRS receives. This year, the IRS has increased its e-filing promotion as it works to achieve Congress' twin goals of e-filing 80% of all tax and information returns by 2007 and e-filing all computer-prepared returns by 2002. The 1040 tax booklet finally stresses e-filing. IRS public service announcements and marketing material are good. The agency is cooperating well with practitioners. The IRS has targeted a 20% increase this year—through April 2 e-filed returns are up 16.7% with just over half the returns in. Led by Assistant Commissioner Bob Barr, the IRS has also published an e-filing Strategy for Growth, invited industry partnerships to increase e-filing, and launched the Electronic Tax Administration Advisory Committee required by RRA98.

This year, in addition to eliminating e-filing fees for clients in 75% of our offices, H&R Block offered free 1040EZ preparation and e-filing on our taxcut.com Web site to 24 million eligible taxpayers. And 7,500 of our offices were approved to participate in a test of personal identification numbers (PINs) in place of paper signature forms to authenticate e-filed returns. PINs reduce the burden of mailing and enable e-filing to be nearly paperless. We consider the test successful and hope it can be expanded. We also assisted the IRS by distributing 500 of its excellent public service announcements promoting the child credit to local TV stations with whom we place our ads.

The IRS had a number of e-filing glitches this year: improper reject notices, erroneous letters indicating forms were missing, inaccurate information given to taxpayers on the TeleTax line regarding the status of their refunds, delayed deposit of refunds, a review of more e-filed returns than planned, and backlogs caused by larger-than-anticipated files. But most problems were resolved quickly. At one point, our e-filing traffic was rerouted because of processing delays to another service center. We found the IRS staff responsive and diligent. Past problems with pre-refund examinations of returns claiming the earned income credit, which caused poor communication, delayed refunds, and a failure to honor taxpayers' direct deposit requests, have improved.

This year, the IRS's TeleFile program for 1040EZ returns declined for the first time since its inception—down 5.6% so far. Possible reasons include the inability of TeleFile to process some new tax provisions, the availability of free Internet alternatives, and reduced commercial e-filing fees.

- *E-Filing Recommendations.* The IRS is making extraordinarily good progress after a long history of modest success but more needs to be done to achieve Congress' targets. Indeed, despite best efforts, the IRS itself projects reaching only 33% of returns being e-filed by 2005, and it probably won't hit the 2002 interim target of e-filing all practitioner-prepared returns. Unless more Americans overcome apprehensions and more practitioners enlist, the IRS will fall short of Congress' goals.

The IRS is on the right track. Our suggested priorities, many already a part of the IRS' strategy, include: (1) a continuing focus on private-sector cooperation, (2) expanding the IRS marketing and promotion, (3) universal PINs to enable paperless filing, (4) adding more forms and attachments that can be e-filed, (5) streamlining the application process to make it easier for tax practitioners to become an Electronic Return Originators (EROs), (6) updating old rules for the e-filing program, (7) revamping TeleTax so taxpayers have more accurate information on return and refund status, and (8) easing suspension rules for EROs—high ERO application standards and stringent suspension rules are barriers that deter participation in the program. Each of these will help increase electronic filing.

- *PC Tax Software.* Last year, 15 million returns were self-prepared using PC software; this year more than 20 million are expected. Block Financial's Kiplinger TaxCut® PC software reduces average self-preparation time to two hours from the 17–24 hours the IRS estimates is needed. The software interview calculates data, enters it on appropriate forms, and audits the return for missing information, missed deductions, etc. In the last two years, e-filing by TaxCut® customers is up over 700%. We expect continued growth in this market as consumers find it an ap-

peeling way to save on preparation time and cost and help navigate complex Tax Code provisions.

- *Internet.* This year, to reduce the cost and burden of filing simpler returns, our Block Financial subsidiary offered a program of free tax preparation and e-filing for anyone qualifying to use the Form 1040EZ—24 million taxpayers with wage income under \$50,000, no dependents, and no itemized deductions. Over 23,000 visitors to our taxcut.com Web site have used the program to prepare and e-file their taxes. While the Internet is a hot medium and we expect it to attract more filers in the future, issues of privacy and security still concern many users.

- *IRS Web Site.* The IRS continues to innovate with its Web site. It's excellent and contains much helpful information, but it could be better organized. Visitors are able to ask tax law questions and receive e-mail answers. Our test questions received timely and accurate responses. The IRS uses the practitioners' corner on the site to alert us to problems. This has worked well. The site also contains hyperlinks to private-sector Web pages like our hrblock.com and taxcut.com to facilitate problem solving and increase e-filing. We, in turn, and others provide links back to the IRS' site.

- *Y2K.* The IRS continues to make good progress. We testified on the subject at the full Committee's review on February 24, 1999. H&R Block will be included in end-to-end testing the IRS plans later this year, which we appreciate.

- *Complexity.* The Tax Code is growing more complex. Complexity concentrates on about one quarter of taxpayers with complex financial lives and multiple sources of income. But it is becoming a more serious problem for a growing group of middle- and low-income taxpayers because of complex calculations for the child credit, IRA conversions and distributions, some earned-income credit computations, and expanding application of the alternative minimum tax (AMT).

Over a thousand Tax Code changes in the past few years have challenged tax practitioners as well as the IRS and tested our trainers and software programmers. This has been compounded by the IRS modifying instructions, worksheets, and forms throughout the tax season, requiring rapid response. Changes in the Form 8606 for IRA conversions in March, for example, caused some taxpayers to overpay or underpay, requiring amended returns. Many taxpayers were also confused in determining where to record information for their child credit.

In each of the last three years, we have sent the Ways & Means Committee, the Senate Finance Committee, the Treasury, and the IRS ten modest suggestions for Tax Code simplification, several of which have now been enacted. The 1999 edition is submitted for the record. We look forward to working with you on your efforts to simplify the tax law, especially as it affects average American families.

- *Use of Paid Preparers.* About half of all taxpayers use paid preparers. While complexity and accuracy are certainly major reasons, many clients also come for counsel because of frequent changes in tax law or life changes—marriages, births, moves, or retirements. Many also come to speed their refunds, which 70% of taxpayers receive. And many also come for convenience: they may be capable of changing the oil in their car, for example, but prefer paying a professional to provide more time for family or other pursuits. Some have math anxieties and some have language problems. The number of taxpayers using professional preparers has increased slightly in the past few years (from 47.9% in 1990 to 49.6% in 1994, 49.9% in 1995, 50% in 1996, and about 51.7% in 1997—the numbers aren't final.). Paid preparers provide over 80% of all e-filed returns. The numbers of taxpayers using PC tax software is increasing more dramatically.

- *1040PCs.* Some clients still don't trust e-filing and prefer paper. H&R Block assisted the IRS in developing the 1040PC in the early 1990s to expedite paper return processing. It condenses the information on a 1040 return averaging 11 pages to one or two pages. It was designed to be used with optical scanners, but that program was abandoned by the IRS and the data are now manually transcribed. The IRS is considering abandoning 1040PCs because it says the format is hard to read, the IRS' data entry has a high error rate, and e-filing is growing.

Many practitioner groups, including H&R Block, prefer the 1040PC because it saves paper and printing costs. For our company-owned offices, it saves about \$300,000 annually. We believe problems can be solved without abandoning an abbreviated form which is still a needed alternative to mounds of paper. We hope the IRS will invite private-sector help in improving and using condensed forms and exploring other innovations to make paper work better. Indiana, for example, is experimenting with bar codes on paper returns to help scanning.

- *IRS Forms and Publications.* The IRS continues to revise and simplify its forms and publications. It has acknowledged errors and posted corrections quickly on its Web site. This is a significant change because, in prior years, the agency rarely acknowledged such errors. There are, however, still problems traced to recent Tax

Code changes relating to information documents including W-2s for deceased taxpayers, 1099-Ts, MSA reporting, 1099-Rs for transfers between regular and Roth IRAs, and 1099-MISC for attorneys fees and legal settlements.

- *Use of New Tax Provisions.*

- *Child Credit.* This is the first year of the child credit. It's been a best seller and made about a third of our clients—and your constituents—very happy. At the same time, because 48 million filers have no income tax liability, millions of low-income families with children receive no benefit (unless they have three or more children), and calculations for some EIC recipients are very complex. Thousands of our Amish and Mennonite clients found it impossible to claim the child credit early in the season because the law didn't allow claims for children without SSNs, and some taxpayers do not use them for religious reasons. We received delayed administrative help from the IRS, but Congress should address the issue so it doesn't reoccur. Also, until Congress enacted a one-year suspension, which we recommend be permanently extended, use of nonrefundable personal credits exposed many middle-income taxpayers to the AMT.

- *Education.* Education credits, education IRAs, and deduction of interest on student loans are popular—about 1 out of every 20 of our clients receives some education benefit.

- *Farmers.* Less successful have been provisions for farmers. The operating loss carryback provision for family farmers is unnecessarily complex. In our experience, income averaging is confusing and not of help to most family farmers.

- *Mutual Fund Investors.* One reporting simplification that helps taxpayers who invest in mutual funds holding foreign securities—raising the amount of foreign taxes requiring filing a Form 1116—has been undercut because the IRS still requires taxpayers subject to the AMT to calculate their foreign credit for AMT purposes by using Form 1116, even when taxpayers are not required to for regular tax purposes.

- *IRS Practitioner Liaison.* Most IRS interaction with practitioner groups comes through formal advisory committees or public liaison meetings. Outreach and information sharing have increased recently. Small business groups and H&R Block are now included, which we appreciate. Status reports and briefings on reorganization are excellent. Because of our size, we also need to work directly with senior IRS officials to manage an ongoing agenda. We are often an early-warning system for the IRS, spotting problems before they generally appear, as with the Form 8806. But sometimes significant time passes before corrections are made. A designated problem-solving contact for large tax preparation firms could help expedite IRS responses. The possibility of national accounts managers, for example, is part of one division's plans—Electronic Tax Administration.

#### FY 2000 BUDGET

The Administration asks Congress to appropriate \$8.1 billion for the IRS for FY 2000. The funds would be for 16 budget functions including customer service, return processing, compliance and law enforcement, and modernization, among other needs. The amount is essentially flat from last year's appropriation.

We support the agency getting the funds needed to do its job, especially in modernizing outdated technology, so that the risk of any system breakdown is reduced and the IRS can catch up to many private-sector organizations in its processing abilities.

#### CONCLUSION

Mr. Chairman, we look forward to working with the Subcommittee to improve our tax system and ensure that for most Americans the tax filing experience is more tolerable. While we can't guarantee that citizens will be any more thrilled about paying taxes in the new Millennium, we are working to ensure that lessons from this tax season will be learned well enough to enable return processing to go more smoothly next year, with refunds issued promptly, and with the IRS continuing on the path to reform and improvement.

I'll be happy to respond to any questions.

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Chairman HOUGHTON. Thanks very much, Mr. Ernst.  
Mr. Harris.

**STATEMENT OF ROGER HARRIS, PRESIDENT, PADGETT BUSINESS SERVICES, ATHENS, GEORGIA, AND CHAIRMAN, FEDERAL TAXATION COMMITTEE, NATIONAL SOCIETY OF ACCOUNTANTS, ALEXANDRIA, VIRGINIA**

Mr. HARRIS. Thank you, Mr. Chairman. My name is Roger Harris, and I am pleased to be here today on behalf of the National Society of Accountants.

The National Society of Accountants and its affiliated State organizations represent over 30,000 accounting practitioners serving over 6 million taxpayers and small business owners. In addition to that, I am representing Padgett Business Services where for over 30 years we have provided through 400 offices accounting and tax services to small businesses. Both of us would be pleased to comment on the filing season, which I agree with most of the comments that we have heard here today, it has been a generally smooth filing season. When we are not hearing complaints from our members, we know things must be going well, and we are hearing few complaints compared to the past.

There are certainly some negatives in any filing season. I think we would all agree with the Taxpayer Advocate's report that the complexity of the tax law is the biggest contributor to any anxiety any of us have during tax season. Also, anytime we see changes in the tax law, things like the Roth IRA and the child care credit, certainly in the early years always creates difficulties as we all adjust to learning exactly what it is we need to know and do to comply with the new laws.

A continuing issue revolves around the earned income tax credit. It is a particularly difficult issue for preparers who are now under a due diligence requirement where they can be penalized, and we have to be very careful, and we rely a great deal on information from clients that hopefully is accurate.

Some of the positives of this tax filing season, again, the Commissioner addressed: The Problem Solving Days, the expanded and improved Helplines. I think there is an overall better attitude when you deal with the IRS now. I think that we would all probably agree that it is beginning to filter down to everyone you deal with.

There is, however, a continued, I believe, lack of training, but, again, hopefully time will address that. We need to have not just pleasant people to deal with but intelligent and well trained people to deal with as well.

And I don't think we can talk about a filing season without addressing, as was mentioned here earlier, the creeping in of the alternative minimum tax as being a bigger issue each year. It is a tax that is viewed by many people as misunderstood and unfair, and I would certainly hope that something can be done in that area.

With regard to the reform of the IRS, the National Society of Accountants has been pleased to have been involved in this process since its beginning. We have supported this legislation and certainly would support the required funding to make sure that the new implementations are made. It is very difficult for us to comment on specific dollar amounts, but I think the restructuring

along taxpayer lines, the technology improvements, certainly require proper funding.

I think we have a unique opportunity because of the fact that we have Commissioner Rossotti as well as this legislation to make a significant change in the IRS. I had the pleasure this past January, along with other members of the NSA Tax Committee, to spend almost 3 hours with the Commissioner and his staff. And I can tell you, having been in those meetings in the past, there was a very, very different attitude from them. They were willing to listen. We shared ideas. I think, as I said, we are at a point in time where we may never have everything in place like we do right now, a Commissioner who, I believe, really does want to change and the legislation to help guide us.

We do share some of the concerns. I share Congressman Portman's concern about the Oversight Board, which is a big part of the restructuring Legislation. We certainly think that the appointments need to take place soon.

Electronic filing concerns us. I don't think, despite what we are doing right now, that the 80 percent goal is likely to be reached. And I think it is equally important how we get there as well as if we get there. And we think that there needs to be some changes perhaps to increase the opportunity for us to get to the 80 percent goal.

There are many other issues with regard to restructuring. I hope that the Joint Committees of Congress will meet and make sure that the message to the IRS is consistent and clear and that they don't get conflicting messages. I think that, again, as I said, we have a great opportunity and we should take full advantage of it.

Again, I thank you for the opportunity to be here today. I hope that our comments will be helpful, and we certainly look forward to any questions that the Committee may have.

[The statement of Roger Harris follows:]

**Statement of Roger Harris, President, Padgett Business Services, Athens, Georgia; and Chairman, Federal Taxation Committee, National Society of Accountants, Alexandria, Virginia**

#### INTRODUCTION

The National Society of Accountants is pleased to testify before the Ways and Means Subcommittee on Oversight and offers this statement concerning the IRS Restructuring and Reform Act of 1998, the 1999 tax filing season, and the Fiscal Year 2000 Budget for the Internal Revenue Service. NSA commends Chairman Houghton and the other members of the Committee for their attention to these substantial issues. They are all of great importance to our membership.

Through our national organization, and affiliates in 54 jurisdictions, the National Society of Accountants represents the interests of approximately 30,000 practicing accountants and tax practitioners. Generally, our members are sole practitioners or partners in small to medium-sized accounting firms. They provide accounting, tax preparations, representation before the Internal Revenue Service, tax planning, financial planning and managerial advisory services to approximately six million individuals and small businesses. The members of NSA are pledged to a strict code of professional ethics and rules of professional conduct.

I am Roger Harris, President of Padgett Business Services of Athens, GA. Padgett provides accounting, tax and financial advisory services to the public through a network of 400 offices located throughout North America. I offer this testimony in my capacity as the Chairman of the National Society of Accountants' Federal Taxation Committee. NSA has been given the privilege of testifying before this Committee on several other occasions, and, as always, we greatly appreciate the invitation.

## PROBLEMS OR CONCERNS WITH THIS YEAR'S FILING SEASON

Shortly after we were invited to testify, we requested feedback from NSA members in all fifty states on any problems or concerns they may have had with this year's filing season. We are pleased to report that there were a low number of complaints or concerns registered by our members this season. While the low number may be partially the result of the heavy burdens of tax season, in the past we have noted that our members will usually find the time to complain, so I view this as an indication that this year's season is proceeding quite smoothly.

NSA maintains a very active tax hotline for its members, and I would like to comment on some of the issues our Tax Manager, Bernie Phillips, has noted from the field.

The first issue is an issue I am sure we are all aware of, and that is the complexity in the tax code. On behalf of the practitioner community, I should probably be advocating that there be even more complexity, since that will mean more clients for our members. We recognize and appreciate the great strides this Committee and the Service have made in this regard, but in the interest of promoting the interests of the public at large, our members still believe more could and should be done to simplify our tax code.

One cannot discuss the 1999 filing season without raising the issue of complexity. This issue has been the number one issue raised by the recent report of the Taxpayer Advocate, and continues to be the number one issue of our members. Complexity has been an ever-present trend in tax law. Although, complexity is warranted in taxing complex transactions, it is a double-edged sword. Unnecessary complexity has furthered the negative perception of the Service because it frequently leads to penalties or other enforcement mechanisms being imposed for understandable errors. Complexity puts the taxpayer on the defensive, which makes transforming the institutional culture all the more important.

The second most frequent issue surrounds the Roth IRA conversion process. The public, and indeed many of our members, needs greater education and guidance on the proper methods for such conversion.

The third issue is the Earned Income Tax Credit. Many practitioners are confused by the eligibility requirements, and are especially concerned because of the due diligence requirements and the repercussions of making a mistake on these calculations. For example, there are certain types of income which need clarification as to whether or not they apply for purposes of the Earned Income Tax Credit. In our view, the rules need to be explained more clearly, especially with regard to the types of income which qualify towards the tax credit.

Our members note with admiration the new and improved IRS Helpline and greatly value the service and convenience this provides. However, some have claimed to have received incorrect or confusing answers from the Helpline. This problem should resolve itself as time goes on, but it indicates that training and education should remain a high priority, and sufficient funding should be ensured to carry out this objective.

Some of our members seem to have encountered a certain degree of inexperience with regard to auditors and audits. Whether this is a result of new rules in effect, or insufficient training, this, of course, is a concern to NSA. NSA believes some of the problems could be resolved through additional training measures or reducing the complexity of the tax law.

One cannot conclude without briefly mentioning one of the most frequent complaints from our members' clients, and it concerns the Alternative Minimum Tax (AMT). More and more of our members' clients have been subject to the AMT, and we have seen a good deal of protest about the AMT tax from these clients. The AMT was designed to prevent abusive use of tax shelters and prevent those circumstances where high-income taxpayers enjoyed little or no tax liability.

The regular income tax was indexed for inflation in 1984. This was designed to progressively tax only real rises in income and not cost of living increases. The Alternative Minimum Tax, however, is not indexed. Since 1986, the figure of allowable credits and deductions, which triggers the AMT, has increased only 12.5%. Over the same period, the rise in cost of living has been 43%.

The net effect is that the AMT is being applied to an ever-increasing percentage of American taxpayers. The Joint Committee on Taxation estimates that in 1997 over 600,000 taxpayers were subject to the AMT. The Committee projects that, given the present environment, this figure could grow to 12 million by 2007. Much of the growth is attributed to middle income Americans taking advantage of new child and education credits.

Senator Richard G. Lugar (R-IN) introduced S.537 on March 4, 1999. His legislation would retroactively index the AMT to inflation dating back to 1993. NSA sup-

ports the outline of this legislation. We feel strongly that Congress needs to address the dramatic growth in the numbers of taxpayers made subject to the AMT. It was never intended to have such a broad application and, in our view, indexing would solve much of the problem.

#### IRS RESTRUCTURING ACT

The National Society of Accountants concurs with a statement attributed to Chairman Houghton in a pre-hearing advisory notice, that the IRS Restructuring and Reform Act of 1998 (H.R. 2676) represents the most significant tax reform effort in more than 40 years. The National Society of Accountants reads a sweeping legislative intent in this landmark legislation. We believe that, once fully implemented, the Act will transform the public perception of the Service from 'us against them' to an emphasis on serving the public and meeting the taxpayers' needs.

NSA believes that full implementation of the Act's legislative intent will require years of vigilant oversight and may require the appropriation of additional funds to the Service to support their genuine reform efforts. This vigilance must be shared between bodies such as your Committee, other Committees who share oversight, the taxpaying public, and organizations such as NSA. While NSA is not prepared to support a specific dollar figure to achieve these reforms, NSA urges the Subcommittee to advocate sufficient resources to support the Service's commendable efforts to restructure and reform its mission.

I would like to comment on NSA's view of the implementation of the IRS Restructuring and Reform Act. First, in recent meetings with Commissioner Rossotti, we experienced a great degree of openness and a new spirit of cooperation. Commissioner Rossotti and his excellent staff helped create an atmosphere where NSA felt comfortable sharing our needs, concerns, and, where appropriate our complaints. It is our view that Commissioner Rossotti and his staff have worked diligently and effectively to transform the public perception of the IRS, as well as made great strides in reforming the "corporate culture" of the IRS to make it more responsive to the public. They have also acted quite adeptly to bring the IRS more in line with modern technology, including upgrading their internal computer systems, easing the process of electronic filing, and upgrading and expanding their web site. All of these factors will, in our view, make the IRS more efficient and help the accounting practitioner better serve their clients' needs and, once again, NSA would fully support appropriate funding levels to ensure the technology modernization program proceeds at a rapid pace.

There are two concerns with the Service's restructuring and reform program which we believe should be addressed. Our first concern is that the Service get clear and unified direction from Congress on both budgetary issues and strategic objectives. It appears from an outsider's perspective that the Service is, at times, being pulled in different directions by different Congressional Committees of jurisdiction and oversight. We therefore view it as important that the proposed House/Senate Joint Oversight Hearings, scheduled to take place by this June, help to achieve consensus on these matters.

Second, NSA is concerned that the deadline for appointing a private sector advisory or oversight board for the IRS is past due, and that the Administration has yet to announce the appointees. This board will help the IRS set and maintain its objectives, including such important goals as modernization and improved customer service, and therefore is vital to the effectiveness of the future IRS.

The IRS employs what is referred to as a voluntary taxpayer compliance system. It is voluntary in the sense that the Service, in fulfilling its mission, is dependent on volunteered information. The Service has historically defined its mission as collection enforcement. We perceive a welcome shift in this mission to encompass assisting the taxpayer and the practitioner in ensuring that tax returns are done efficiently and correctly, while reducing the threat of draconian enforcement penalties.

The Service's mission remains to collect the proper tax under the law. The Restructuring and Reform Act of 1998 doesn't alter this basis dictum. The Act reforms the methods employed to carry out the mission. We believe a customer-oriented approach will ultimately lead to increases in tax collections over the long-term.

Consider the broadest reforms contemplated by the Act; a mandated reorganization of IRS Divisional structure, a broader range of new taxpayer rights, and the creation of new agency oversight. First, the Service will soon become organized according to the unique needs of specific types or categories of taxpayers. NSA has always supported this concept, and, while we cannot comment on the specific budgetary requirements to achieve this transition, we believe the Service should be allocated sufficient funding to ensure a smooth and complete reorganization process.



Second, the Act also establishes a broad range of new taxpayer rights. New taxpayer rights are enumerated which both govern IRS collection activities and provide new avenues of taxpayer redress in the case of a dispute. The Taxpayer Advocate is now the National Taxpayer Advocate. The change in title is accompanied by new rules that bolster the Advocate's independence, promote the Advocate's services, and require a semi-annual Advocate report to Congress. The Act also establishes the creation of a new Oversight Board.

All these reforms contain a common rational thread that strikes at the function of the Service itself. Past Congressional reports have noted taxpayer frustration with the Service's lack of appropriate attention to their needs. A Senate Finance Committee report concluded that taxpayers have a right to receive the same level of service from the IRS that they receive from the private sector. This is what I referred to last Spring as the benchmark goal of 'putting the customer first.'

NSA recognizes the enormity of the task of reforming the IRS in the midst of processing over 200 million returns, issuing 92 million refunds and responding to over 120 million requests for assistance. NSA is convinced that Commissioner Rossotti is personally committed to seeing reforms through that over time will achieve the institutional transformations discussed above. Further, NSA is mindful of the fact that the Service has just begun the arduous reforms contemplated by the Act. These initial efforts demonstrate a high degree of initiative, which have led to improved customer service and which will continue to improve taxpayers' attitudes toward the Service.

Problem Solving Days are one example of this effort. Held monthly around the country, Problem Solving Days give taxpayers the opportunity to meet face-to-face with Service personnel to work out tax problems. Another example is improved telephone access during extended operation hours. In addition, the IRS web page is an excellent resource for taxpayers and practitioners alike. NSA members acknowledge and appreciate the Service's efforts in these areas.

NSA remains concerned that there still remains pockets of the "old-style" IRS that perhaps have not received the message from the top. One of NSA's past Presidents, who practices in Missouri, recently told us of a rather extreme example of what can happen when IRS employees mishandle tax returns or fail to adequately correct errors made by the IRS itself. While one cannot generalize from one example, it appears that the problem might have been resolved simply by taking the time to listen to the taxpayer. With the new openness and desire to improve service, we hope and expect these types of problems will be few and far between.

Taxpayer rights will continue to be a primary goal of NSA and its members. We are greatly encouraged by several new initiatives in this regard, specifically the relief for innocent spouses who filed joint tax returns, and newly announced rights for taxpayers faced with collection activities, such as requiring pre-levy notices. Yet another encouraging part of the restructuring program is the development of new performance measures which take into consideration how the IRS employee treats taxpayers. We eagerly await the implementation of these new performance measures, although we recognize that "corporate culture" cannot change overnight. However, in time I believe we can all expect to see a much more customer-oriented approach to collection activities.

#### ELECTRONIC FILING GOALS REMAIN A CONCERN

The IRS Restructuring and Reform Act of 1998 includes a number of positive provisions designed to encourage more tax professionals and taxpayers to utilize electronic filing. To the credit of the Service, the electronic filing of tax returns has continued to surge in popularity among taxpayers during the 1999 tax-filing season.

As of March 12th, the IRS reported receiving 17.2 million returns filed electronically, a 16.5% increase over last year. The vast majority, 15.8 million, were filed by tax professionals. The IRS also reports receiving 1.4 million returns from home computers, a 160 percent increase. However, a recent survey published by Jupiter Communications suggests that the taxpaying public is hesitant to trust e-filing for such an important transaction, citing security, privacy and reliability concerns. As an example, Jupiter surveyed 2,100 Internet users and found that only 1.4% would file via the net, while approximately one-third said they would hire an accountant, one third were using non-internet software to prepare their return, and a third would prepare their returns by hand. The report concluded by noting that consumer behavior does not change as quickly as some assume, especially with highly sensitive, low frequency activities such as tax filings.

In NSA's recent meeting with Commissioner Rossotti and his staff, we took the time to discuss the IRS goal of the percentage of returns electronically filed, which, by 2007, is a goal presently set at 80% of all returns. I believe the current percent-

age of e-filed returns is stands at approximately 20–25%, so much work lies ahead to reach this ambitious objective. I believe the only way to approach this goal is to keep in mind the needs of the accounting practitioner. With over 50% of all returns prepared by a professional tax preparer or accountant, we need to make the process of electronic filing more advantageous and less complicated for the practitioner. I propose two ways of achieving this; first, there have been several complaints from our members that they have had problems having their e-filed returns accepted by the IRS. Whether this is a result of computer glitches, or simply a result of the IRS not presently being capable of accepting all forms, it is understandable that many practitioners would find it simpler to print the more complex returns and file them by mail.

Second, it is our view that the IRS could encourage e-filing by improving incentives, and reducing the disincentives for e-filing. This Committee has heard numerous times about these disincentives, so I won't repeat them here. NSA remains concerned that Congressional goals of an 80% e-filing by 2007 may not be achieved without continual dialogue between the IRS with organizations such as NSA, as well as ongoing refinements and improvements on the part of the IRS. While we are pleased to note the increase in e-filings, we cannot remain complacent with this achievement. Suffice it to say, we should continue to explore the underlying reasons for the failure of many taxpayers and practitioners to e-file their returns, and NSA, for its part, is eager to continue discussions on this matter with the Congress and the Service.

I would like to conclude by thanking the Committee and Chairman Houghton for their leadership and attention to these issues which, if adequately addressed, will help America achieve a more effective, efficient, customer friendly, and progressive tax collection environment. NSA, for its part, is pleased to remain an active part of the process in helping the IRS achieve its modernization and reform objectives, and is greatly encouraged by the achievements made thus far. Thank you.

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Chairman HOUGHTON. Thank you very much, Mr. Harris.  
Now, Ms. Joyner-Rodgers.

**STATEMENT OF DONNA JOYNER-RODGERS, MEMBER, GOVERNMENT RELATIONS COMMITTEE, NATIONAL ASSOCIATION OF ENROLLED AGENTS, GAITHERSBURG, MARYLAND**

Ms. JOYNER-RODGERS. My name is Donna Joyner-Rodgers, Mr. Chairman, Members, staff. I am in private practice in Las Vegas, Nevada. I have been an Enrolled Agent since 1987. Our firm prepares approximately 4,000 tax returns in a filing season. Of these, we probably send 70 percent electronically. This year I have prepared over 500 myself.

As a member of the Government Relations Committee of the National Association of Enrolled Agents, I am very proud to be here to have a chance to give testimony. We have 35,000 enrolled agents in the country, of whom about 10,000 are members of our Association of Enrolled Agents.

You have my written testimony, which I submit for the record. I would like to summarize my testimony.

I had originally planned to save the electronic filing for last, but since there has been such an interest in it I have reordered my comments. And I would like to address those now.

I do believe electronic filing is the way of the future. We have been filing electronically in our firm for 10 years. I think the taxpayers like the convenience of it. They like the fact that they can get a refund quickly. There are, however, some hurdles to getting the tax professionals to buy into electronically filing, and one is not a new story. I know it has been heard and said before, and that is, there are many forms that cannot be accepted electronically.

This may come in with what Commissioner Rossotti was talking about, the modernization. These forms keep many people from electronically filing when they truly would like to buy into the system.

This is usually some of the more complex forms. If you take that one step further and consider the fact that the more complex forms can also cause errors when they are data-entered at the Service Center, it would make good sense to make these forms accepted electronically.

Another problem I see for the practitioners is the electronic return originators facing the strict procedures. I agree the procedures do have to be strict in order to make sure there is no fraud. We buy into that 100 percent. However, often the punishment for making a small error, which is the revocation of the license to electronically file, is overly harsh. Tax professionals who file by paper do not face this harsh sanction. Therefore, if there was some other procedure, a warning or perhaps some appeal procedure, then you might be able to get them more into the idea of filing electronically.

Once you do have people buying into the procedure of electronic filing, there is a great resource for the electronic filing originators, and that is the help desk at the Service Center where you do your electronic filing. I personally have had quite a lot of interaction with the help desk up at Ogden Service Center, headed by John Young. His people are very responsive. They are receptive, very helpful when it comes to a problem of a return that got sent and that we can't seem to work out the problem. They get right back to you. So once you have gotten online and you are doing the electronic filing, they do a lot to help you make it go smoother.

Those are my comments on the electronic filing right now I would like to address. As an overview, we also from our members have gotten feedback that it has been a very smooth filing season, much smoother than the nightmare of 1995. The IRS is to be commended in some of their systems they have put into place. I particularly have been very pleased with the Problem Solving Days. They have made them available throughout the filing season, and the Problem Solving Days are a great way to help people get down to a problem that systemically has not been able to be solved. In addition to the Problem Solving Days, there are 250 walk-in sites. Everything has been a big help.

Thank you very much for letting me address you.

[The prepared statement follows:]

**Statement of Donna Joyner-Rodgers, Member, Government Relations  
Committee, National Association of Enrolled Agents**

Mr. Chairman, Members, staff and guests, my name is Donna Joyner-Rodgers and I am an Enrolled Agent engaged in private practice in Las Vegas, Nevada. I have been an Enrolled Agent for more than a dozen years. Each year, my firm handles approximately 4,000 individual and small business tax returns. Sixty-nine percent of these returns are filed electronically.

As a member of the Government Relations Committee of the National Association of Enrolled Agents, I am very pleased to have this opportunity to present testimony on behalf of the Enrolled Agents, all of whom are tax professionals and the majority of whom are also small business owners.

As you know, Enrolled Agents are licensed by the U.S. Department of the Treasury to represent taxpayers before the Internal Revenue Service. Enrolled Agents, along with attorneys and CPAs, are governed by Treasury Circular 230 in our practice before the IRS. Enrolled Agents were created by legislation signed into law by President Chester Arthur in 1884 to remedy problems arising from claims brought to the Treasury after the Civil War. Today, we represent taxpayers at all adminis-

trative levels of the IRS and provide tax preparation assistance as well, thereby affording us a front-line perspective on the administration of our nation's tax laws. There are approximately 35,000 Enrolled Agents, about 10,000 of whom are members of NAEA.

On behalf of my Enrolled Agent colleagues, I would like to express appreciation to the Oversight Subcommittee Chair, to the Members and staff for your annual review and evaluation of filing season and the IRS budget and operations. We believe you are making an invaluable contribution to improving our system of tax administration by regularly scheduling these hearings. They offer an opportunity for the practitioner community to share its views, an occasion for the IRS to provide information on its needs, and it sets an annual benchmark against which we can measure accomplishments, highlight problems and seek remedies.

#### 1999 FILING SEASON REPORT CARD: AN OVERVIEW

As we have done in the past, NAEA has kept in touch throughout filing season with its members. Through our online communications and surveys, we gained insights to what Enrolled Agents, as front-line practitioners, are seeing. Our members have told us that this has been a very smooth filing season so far as IRS operations are concerned. Although there have been a few glitches, which will be described later, the overall impression is that—compared with the 1995 filing season from hell—this one has been a piece of cake.

In terms of IRS operations, there are several successes we would like to bring to your attention. First, the IRS web site has been greatly expanded and continues to provide valuable information to both taxpayers and practitioners. Forms, instructions and publications are easily accessible—to be read online or downloaded. The site even includes a place at which problems internal to the agency are listed and provides information on how to deal with a specific problem—for example, a misprinted form or a processing delay. Another spectacular feature is a free tax law research site. You enter your question under one of several headings and e-mail it to IRS for a reply. Early in the filing season, the turnaround time was 12 hours. It has since lengthened, but our experience is that it has not been more than 48 hours.

We have not had practitioners complaining about IRS service as we have had in previous years. We attribute this to the 250 walk-in sites with longer hours of operation as well as the 24 hour, 7 day a week telephone helpline. The investment in these improvements has helped put the Service back in IRS and greatly diminished taxpayer and tax practitioner frustrations.

Having a variety of locations and means by which taxpayers and tax practitioners can acquire needed information to complete a tax return has greatly improved the ability of tax professionals to keep America's taxpayers in compliance. We have been eagerly looking forward to the small business corner which has recently been added to the IRS home page. It provides essential information to small businesses and is accessible to everyone, whether they're in a rural area or a big city.

We commend the IRS for continuing to hold Problem Solving Days, even during filing season. This has substantially contributed to the public perception that IRS is refocusing its mission on customer service. At NAEA we are receiving far fewer calls about long-standing, unresolved problems. Taxpayers seem to be getting their problems resolved at Problem Solving Days where IRS employees with appropriate experience and authority can make decisions. Even if a decision favorable to the taxpayer is not received, taxpayers and their representatives seem to find discussions with knowledgeable, experienced IRS personnel to be very helpful in moving toward a resolution. If every IRS employee had the knowledge, technical tools and authority and were rewarded for solving taxpayers' problems in one sitting, there would be no need for Problem Solving Days.

In 1999, more taxpayers than ever turned to paid preparers to assist them in the completion of their tax returns. This is largely due to the many tax law changes of the past two years, combined with varying effective dates and phase-outs. Our members report increases in business of 10%, 20% and more as taxpayers, confused by so many new provisions, decide that it's better to let an Enrolled Agent handle it.

A month ago, Ann Landers, the Chicago-based nationally syndicated columnist, ran a letter about Enrolled Agents and included NAEA's toll free referral number. We received so many calls that it crashed our system. A month later, we are still receiving more than 200 calls a day from taxpayers seeking a professional to assist them in completing their returns. While we certainly appreciate the extra business, we recommend Congress revisit the issue of tax simplification as soon as possible.

We doubt the intent of recent tax law changes was to confuse taxpayers and add to the incomes of tax practitioners.

#### THE GLITCHES

##### *1. IRS Refund Hotline/Treasury Offset Program*

The IRS refund hotline is an excellent customer service idea. It is designed to provide taxpayers with information on when their refund can be expected. However, for the second year in a row it has not provided taxpayers with timely information. When a taxpayer calls, is told the refund is in the bank and it isn't, the tax practitioner is the one who feels the taxpayer's wrath.

This year, Treasury was authorized to debit nontax debts from refunds. These nontax debts include delinquent student loans and child support payments. However, the Treasury offset program was completely separate from the IRS refund line. To the surprise of our Members, Treasury did not accept the IRS' Power of Attorney, but instead required a separate POA—FMS Form 13. For a time, we could not find a Treasury helpline to which inquiries could be directed. You may be surprised to hear this, but practitioners complained that Treasury was not as "customer friendly" as the IRS!

Furthermore, the two programs—refund hotline and Treasury offset program—were not coordinated. We then had the unfortunate situation where a taxpayer was told the refund had been sent out without being informed that Treasury would be debiting other payments. We hope this can be resolved so that next year taxpayers will get the right answer.

##### *2. Electronic paralysis*

There are two filing season crunches: one in early February when taxpayers with relatively simple returns—W-2 income and few investments—come forward in need of assistance. Usually they are due a refund and would like to receive it quickly. The second crunch time comes in mid March to April 15, when taxpayers with more complicated returns involving, for example, investment income show up.

Early in 1999, tax practitioners experienced problems with e-filing at the Andover Service Center. Apparently demand exceeded capacity. This could be considered a fortuitous circumstance. However, to tax practitioners trying to meet clients' expectations, it was very frustrating. It was fixed within a few days but it came at a critical time for practitioners. We were told of similar problems at the Cincinnati Service Center.

Also, due to human error, tax returns involving Earned Income Tax Credits—many of which are e-filed—were held up in Atlanta for additional review. While some review for revenue protection purposes had been anticipated, the numbers involved far exceeded expectations and there were delays for taxpayers who are often in need of the EITC to pay rent, medical bills, auto repair bills, etc. The IRS did acknowledge this problem on their web site and explained how the situation would be remedied. As practitioners, we very much appreciated having this information to share with our clients. It is another sign of the cultural shift at the new IRS.

##### *3. Continued inability to e-file all forms and schedules*

For the second year in a row, we bring to your attention the problem of tax practitioners who would be willing to convert their operation to e-filing but who are still finding that too many forms cannot be filed electronically. NAEA readily understands the priority the IRS must give to ensuring its systems are Y2K compatible. However, if IRS is to meet its target of 80% of returns filed electronically, it must pick up a very substantial percentage—perhaps as much as 95%—of practitioner-generated returns.

As I mentioned at the beginning of my testimony, roughly 70% of the returns my firm handles are e-filed. We would do more, if only the forms could be filed. Unfortunately, those returns which cannot be e-filed are those which are more complex. At the Service Center, they must be keyed in by hand which is where data entry errors can occur.

There are other impediments to e-filing: If a taxpayer has more than 50% of his or her pension withheld for tax purposes, the return will not qualify for e-filing. Or if a taxpayer uses more than 4 day care providers in a year, the return will not qualify for e-filing. Yet there are times when children whose parents both work will send them to the YMCA camp, then basketball camp, soccer camp and Scout camp over the summer. These are not unusual circumstances but apparently for revenue protection purposes, willing taxpayers are being turned away from e-filing.

There is also a disconnect between reaching a goal of 80% of returns e-filed and requiring original signatures on forms. During meetings with IRS Electronic Tax Administration officials, NAEA had proposed that forms which cannot be electronically filed be retained by practitioners as work papers. We suggested a pilot program involving Circular 230 practitioners—Enrolled Agents, CPAs, and attorneys who are regulated by the IRS’ Director of Practice—but were turned down by Chief Counsel’s office. We were advised that the legal statutes are an impediment to e-filing and only Congress can change the statutes. However, the IRS Reform and Restructuring Act, Title II, Section 2003 permits alternatives to original signatures.

As it stands now, the burden placed on practitioners to maintain a two-track system—paper and e-file—is a major obstacle to practitioner acceptance of electronic filing. To quote from one of our Members who responded to our online survey,

“Electronic filing really worked well in the technical sense. It remains, however, nightmarishly complex to administratively keep track of the electronic returns going out, acknowledgments received, acknowledgments pending, lost returns (yes, there were several), lost acknowledgments (again, several), filing of the paper Form 8453 and sending out the Form 9325 to the clients.

Ditto that for the state returns. It all requires a separate administration system that MUST be kept up to date at least daily and sometimes hour by hour.”

We would argue that the current e-file system in its complexity is a disincentive to practitioners who are attempting to modernize their practices and who would be disposed to do so if there were not so much red tape.

IRS’ statistics show that the number of e-filed returns overall is up 15% over last year and the number of returns filed to date is up 3%. Clearly, we are going to need more initiatives aimed at practitioners in order to get to that 80% benchmark, otherwise we are going to fall far short of that target.

There are other systemic issues which require attention. We would note that Electronic Return Originators (EROs) face strict procedures. Breaking even one, can result in suspension from the electronic filing system. In order to combat fraud, the measures are tough. And we would agree with the need for supervision. However, often the punishment—revocation of a license to e-file—is overly harsh. A tax practitioner who files paper returns does not face the same harsh sanctions, so the system provides plenty of incentives for practitioners to stay with paper.

On the other hand, in its efforts to reach out to taxpayers and increase e-filing, the IRS has, at times, undermined both the stature of the tax professional and its own insistence on doing things by the book. *Attachment A* is a copy of an advertisement which ran in the *Washington Post*. The furniture company suggests that taxpayers bring in their W-2s and 1099 forms to obtain quick cash and offers a refund loan. One wonders about the due diligence requirements imposed on that particular Electronic Return Originator. The IRS web site offers taxpayers access to local e-filers by zip code, including a liquor store in St. Petersburg, Florida.

The recently established Electronic Tax Administration Advisory Committee or ETAAC could be an excellent way to find out what tax professionals need in order to convert to e-filing and to stay with the system. We endorse this kind of outreach, emblematic of the new IRS, which we believe can make a difference in eliminating institutional obstacles to practitioner use of e-filing.

#### *4. Impact of Earned Income Credit (EIC) Due Diligence Requirements*

The Earned Income Credit continues to provoke anxiety among our members. As we noted last year, the due diligence requirement significantly increased prep time and paperwork. You cannot wring the fraud and abuse out of this program on the backs of the tax practitioner community. And failing to do so, has had its own unanticipated results. As one of our members states:

“I have stopped taking any client who may be due the Earned Income Tax Credit. I returned their papers and requested they go elsewhere to get their tax return done. The reasons? The risks of penalty in erroneously designating a child as “qualified” when the parent(s) is/are divorced, legally separated, living apart, cohabiting with someone other than the spouse (or whatever) make the determination too risky. Add to this that the taxpayer could have been previously excluded from the EITC and I might forget to ask, or he/she might not tell me or might falsely advise me or not know themselves that they were excluded. Add to this the requirement to ask a client to sign an EITC statement that is incoherent to any average American reader and make me keep that statement on file is all just too much. I have opted out of EITC all together.”

## IRS BUDGET PRIORITIES FOR FISCAL YEAR 2000

We would commend the current management of the IRS for its thoughtful, deliberate approach to setting out its budget priorities for FY 2000. There is little to disagree with in terms of program emphasis and direction. Clearly, the Service is attempting to meet critical needs such as Y2K compliance which Commissioner Rossotti has likened to changing a jet engine while the plane is in the air. Simultaneously, IRS must fulfill its Congressional mandate to reorganize, implement additional taxpayer safeguards, and upgrade its computer system. Taken individually, these are significant challenges for any organization. IRS is to be applauded for not only taking on these challenges but, from our perspective, making strong headway in achieving them.

## REORGANIZATION INTO FOUR BUSINESS UNITS

The vision of four customer-focused business units is one of the most appealing aspects of the reorganization plan which we have seen only in outline form at this time. To finally have one-stop shopping for individuals, small businesses, the self-employed, tax exempt organizations, and mid to large corporations seems to us to be the epitome of customer service. We believe this will be tremendously user-friendly and end much confusion among taxpayers. We are particularly receptive to the emphasis on taxpayer education because we strongly believe that most taxpayers want to comply with the law but some may not know how to do so.

While endorsing the concepts we have seen so far, we do have a few unanswered questions which we hope will be clarified once the reorganization plan is unveiled April 15. These include:

1. What role will various advisory committees such as the Electronic Tax Administration Advisory Committee (ETAAC), the Information Reporting Program Advisory Committee (IRPAC), and the Internal Revenue Service Advisory Committee (IRSAC) continue to play in the newly reorganized structure? One of the most important things IRS has done in recent years is to provide opportunities for tax practitioners, taxpayers, academicians, and industry representatives to gather to share information and insights on tax administration. We would be highly disappointed if these cross-cutting opportunities were lost.

2. One of the best things IRS management has ever done was to create the Office of Public Liaison at the National Office about 4 years ago. Finally, there was a way to communicate with IRS in a regular, coordinated manner for tax practitioners, small business, various industry groups, and association representatives. We would hope that so successful an effort would be continued at the highest levels of the Service as a focal point for discussion of issues and dissemination of information. As part of the Public Liaison outreach, we have had regular updates on the modernization effort so as practitioners, we can be part of the process. This is very much in keeping with the new way of doing business at the IRS.

3. Accountability is an integral part of the reorganization. We commend IRS management for recognition of the fact that without accountability you can have all the vision in the world but it won't mean the organization will change in meaningful ways. We do, however, have concern about the operation of the Chief Counsel's Office. Our experience is that if any component of the IRS poses a threat to reform, this is it.

Taxpayers and practitioners deserve timely guidance if they are to comply with the law. Yet our experience is that frequently, Chief Counsel's office is oblivious to the practical demands of the business world. To give one example, the Taxpayer Relief Act of 1997 included a provision requiring tax practitioners to perform due diligence when a client requested an Earned Income Credit. Discussions with appropriate personnel in Chief Counsel's office began in July 1997, prior to enactment of the new law. Further discussions were held in mid-September. Practitioners representatives were advised that guidance would be available by the end of the year. There was no comprehension of the fact that tax practitioners would be preparing themselves and their staff for filing season in October and November. One comment was, "You'll have something by December 31. That should be good enough." On the Wednesday before Thanksgiving, NAEA representatives paid a courtesy call to the newly appointed Commissioner. He asked if we had any particular concerns and NAEA advised that if guidance on due diligence for EIC wasn't forthcoming, penalties would have to be waived. It was unfair to expect practitioners or taxpayers to understand a complex new law without some type of guidance. A few days after the Thanksgiving weekend, guidance was released. Clearly, it looks to us as if intervention by the Commissioner himself was necessary to get Chief Counsel focused on the need for critical taxpayer information.

In our discussions with other practitioner groups, our view is repeatedly validated. Chief Counsel's office must be made accountable. Lists of regulatory and guidance projects are a good beginning. However, we hope that through Congressional oversight, that office will be made to put out guidance in timely fashion.

4. Proper placement of taxpayers in business units is beginning to become a concern to our Members. Our society is very complex and some businesses may not fit neatly into a particular unit. What will happen to—and this is a real example—the taxpayer who heads up a \$2 million–\$3 million corporation with 2 employees? Will he fall into the mid to large corporation unit because he is incorporated? Or will he be considered a small business? If he has employee tax issues, to whom will he address them—the small business unit or the mid to large corporations unit?

5. Information reporting, including the issuance of Forms W-2, is one of the most critical elements in tax administration. Amounts that are accurately reported on information returns are significantly more likely to be reported properly on the recipients' individual tax returns. It is estimated that over 97 percent of the wages reported by employers on Forms W-2 appears on the individual returns of the employees. Thus, the IRS has a strong vested interest in ensuring employer compliance and cooperation with the information reporting rules.

It is our understanding that the Office of Employment Tax Administration and Compliance will be placed in the small business operating unit. The following are a number of issues concerning the reorganization which have been raised by the Information Reporting Program Advisory Committee (IRPAC), chaired this year by Judith Akin, EA who is a colleague in NAEA:

- How will this office effectively communicate with the other operating units to solve the needs of other employers and their employees?
- To whom will the Director of OETAC report?
- Where will businesses go in order to resolve employment tax issues and questions as they arise and relate to information reporting?
- Will one business unit be able to address the employment tax issues arising from employers and employees under the jurisdiction of all four units? If so, what procedures would be put in place to implement this task?
- How will the IRS spread its limited existing employment tax resources across the four business units?
- How will the IRS ensure that the small business operating unit will dedicate appropriate resources to employment tax issues that do not directly impact small business employers?
- How will the close coordination between Form W-2 and Form 1099 processing and information reporting be continued to enable the IRS to quickly resolve problems as they arise?
- How will the IRS ensure that employment tax issues are consistently applied to employers in all of the business units?
- Which branches within Chief Counsel's office will have responsibility for the regulations, revenue procedures and rulings on information reporting, withholding and the related penalties for each of the four broad areas and how will the branches coordinate among themselves: (a) Domestic—information reporting on Forms 1099 (other than Form 1099-R) and section 3406 back up withholding and related penalties; (b) Employment taxes—information reporting on Form W-2, withholding on wages and related penalties; (c) Qualified plans—information reporting on Forms 1090-R and 5498 and section 3405 withholding; (d) International—information reporting on Forms 1042-S, withholding payments on nonresident aliens and the related penalties?
- Will the IRS Forms and Publications division remain a centralized function at the national level?
- Will the reorganized IRS maintain a centralized call site at Martinsburg Computing Center to answer questions regarding the filing of information returns with the IRS for payors, withholding agents and employers?
- Will the IRS reinstate the centralized employment tax call site that was a pilot project last year?
- Will the IRS have a national director of the Information Reporting Program with sole responsibility for payor compliance with reporting and withholding rules?

Many of these questions may be answered with the unveiling of the April 15 reorganization plan or in details to be issued soon after. However, we believe they are so important and so integral to the functioning of our tax administration system, that they must be raised here as well as at the highest levels of the Service.



## CONCLUSION

It is our hope that our comments have provided some idea of the status of filing season and IRS operations. Commissioner Rossotti, IRS' senior management, and IRS employees throughout the nation deserve high praise for their earnest response to Congressional mandates for reform. It takes more than words to turn around an agency the size and scope of the IRS, but the work is well underway. We thank you again for the opportunity to share our views.

ATTACHMENT "A"

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Chairman HOUGHTON. Thank you very much, Ms. Joyner. Would you like to ask questions?

Mr. COYNE. Yes.

Chairman HOUGHTON. OK. Mr. Coyne is going to ask questions.

Mr. COYNE. Thank you, Mr. Chairman.

I would just like to generally ask the panel: Congress passed last year the Taxpayer Bill of Rights 3 as part of the Restructuring and Reform Act of 1998. I was wondering if you could comment on what effect TBOR3 has had, at least up until this point in the filing season.

Mr. HARRIS. I would say at this point, really, it has not had a significant impact on anything that we have seen this year. I think a lot of the things, the rights, until you are in a position when you need to exercise them, will not be important to you. It is just I think, too early for us to make a judgment.

I think when we have the opportunity to explain the new rights to taxpayers, they are very happy that they have them. But, fortunately, we have not had to use a lot of them at this early stage.

Mr. COYNE. Are there any additional safeguards that you would recommend that Congress consider enacting?

Mr. HARRIS. From a taxpayer rights standpoint at this point?

Mr. COYNE. Yes.

Mr. HARRIS. I think that we are going to need to have some of the things clarified. I think, for example, exactly what privilege we have now as preparers or representatives is still a little unclear to us in terms of what kind of communication is privileged, what types of communications, written and oral. So I think clarification may be more important right now than additional ones, and I think, again, time may solve all those.

Mr. ERNST. Just to add to that comment, one of the things that we are seeing is the dual role of the tax practitioner. Our role as an advocate or support for the taxpayer often gets muddled with our dual obligation to also ensure that the return is done accurately and that the information that we are getting from our clients is correct. So I would concur that clarification on what specifically our role is and where our role starts and stops would be very useful.

Mr. COYNE. Getting back to complexity, I wonder if you could comment on what are the three most common problems that face practitioners and taxpayers during this current filing season.

Mr. ERNST. Well, we have clearly seen that the child credit has created a fair amount of concern, and I would say that it is primarily because it is something new. It is something that people have to understand how it interacts with the other aspects of their tax return. So that is probably No. 1.

Education credits have been both well received but also a source of confusion, and probably the most significant thing that we are now dealing with are Roth IRA conversions, and specifically the rules around Roth IRAs.

Mr. HARRIS. I would agree that I think most of the new things that came into play this year were the ones that were probably the most complex. Fortunately, for most taxpayers, it meant that their

refund was higher, so they were happy to find out that this complexity was there.

Again, the only other thing that I would mention is this creeping in of alternative minimum tax as being a bigger and bigger issue. I think if we don't address that issue in the future, we may find that to be a major problem in a few years.

Mr. COYNE. Thank you very much.

Chairman HOUGHTON. All right. Would you like to ask a question, Mr. Portman?

Mr. PORTMAN. Thank you, Mr. Chairman.

Let me start by thanking you all for all the work you have put into this over the last few years in terms of getting the IRS Restructuring and Reform Act enacted, first passed and then now being implemented, and we do applaud the work you have done. I just read through your testimony quickly, Mr. Harris, and you were involved in this for the last few years, helping us put together something that made sense. But as you say, it is going to take time, effort, and continued vigilance by this Subcommittee and others, and I know we are committed to do that.

Mr. Coyne was on the Commission. Mr. Houghton who has been Ranking Member of this Subcommittee with Jake Pickle for years, understands the problem, and I think we are well positioned to be able to follow it.

I guess my question to you would be along the lines of what Mr. Coyne asked. You know, what are the aspects of the Restructuring Act that are going to need work. I will just ask you about one specific one, and that is electronic filing.

We put in the bill, the goal of 80 percent electronic filing by the year 2007. We put a lot of time and effort into coming up with that number. We are now told by the IRS that may be unrealistic.

I think that virtually all tax preparers would have to file electronically for us to meet that target. I don't know if you agree with that assessment. I would like to know what you think about that.

I also think, though, that all tax preparers are using computers, so why not? In other words, it is an ambitious goal, but I think it is one that is attainable so long as we can come up with the proper incentives and the lack of barriers to be able to convince people to file electronically rather than printing and mailing.

So I guess my first question is: Do you agree with my assessment? And, second, what percentage of the returns currently among your members—and this would include H&R Block and the enrolled agents and the accountants. What percentage of returns would you say that are prepared by your members are filed electronically now? And what are some of the impediments you still see?

Mr. HARRIS. Well, percentage-wise, obviously this season I can't tell you exactly, but it is probably close to the average, maybe even slightly below, because a lot of our clients are small businesses who file more complex returns which cannot be filed electronically today.

Second, we don't have a great demand in the small business community for electronic filing. They typically don't get refunds. And electronic filing I think right now is perceived as a benefit to people with refunds.

I have heard the Commissioner's comments about accuracy and all these sorts of things. People expect accuracy for the most part, and we are going to have to find other ways to bring the small business community to customers who demand this service. And right now they don't. They see no benefit in it to them, and, in fact, they see more disincentives than incentives.

Mr. PORTMAN. What would be the disincentive?

Mr. HARRIS. Well, I think one that is obvious—and I have talked to a few people about this—is that they are told that they can file electronically, and even though they have a balance due, it will not be taken from their bank account until April 15.

What I think is not being understood is that some of these people, because they mail their return on April 15, have 3 or 4 critical days to raise the money, and it is actually a disincentive to take it from their account on April 15. Their paper check will not be processed that day. So they lose some control, and to a small business owner, those 3 days to a week can be critical.

So perhaps if you could put an incentive in that if you electronically file the return the money comes out at a later date, you would have, I think, a lot of small business owners demanding it.

Mr. PORTMAN. I see Mr. Ernst nodding his head in agreement. As you know, I was supportive of having a 30-day extension and pushed it hard and wasn't able to prevail in that. But if that is a big difference, we ought to try to evaluate that in a more systemic way, try to get those statistics, and we would love your help in that.

Mr. Ernst and Ms. Rodgers, any other comments on how we can get electronic filing up and whether the current goal is realistic?

Ms. JOYNER-RODGERS. I don't know if the goals are realistic. We are doing our part to meet the goals. We do file balance-due returns. We have filed balance-due returns for years. The filing of the balance-due returns does not automatically mean the money is taken out of your checking account. If you file a balance-due return, you can mail in a check with a voucher, just like someone who mails a paper return in. So there is no difference in when they get the money if you use that voucher to mail your check in.

Mr. PORTMAN. But then you are having to electronically file and post it. You are having to send it in as well.

Ms. JOYNER-RODGERS. That is correct. When you send in a return that is a balance-due return, the system is set up now that you mail the return into one location; you mail the voucher into another area with your check. The same thing can also be done electronically. You can electronically file your return and mail your check in with the voucher to the lock box.

Mr. PORTMAN. That is great. Well, the Enrolled Agents, again, were critical to this whole reform effort, and you all spent a lot of time on this. So your specific input to this Subcommittee would be helpful.

Mr. Ernst, do you have any final words before my time is up?

Mr. ERNST. I will just comment. Nearly 72 percent of our returns were filed electronically as of March 15. We will electronically file something in excess of 10-million returns this year at H&R Block, and that will be primarily from clients who have refunds. We do not charge, for the most part, for electronic filing as an additional

service, and we find that many of our clients are quick to take our advice on the benefits of electronic filing.

However, we see very little incentive for most of our clients in electronically filing a return where there is a balance due. We think that more cooperation and work between the IRS and the private sector to look at innovative ways in which people can benefit and use a carrot to encourage electronic filing is certainly called for.

Mr. PORTMAN. Well, again, it is up 17.5 percent this year, which is a good sign. But if you look at the projections from now until 2007, given that marginal increases are more difficult to obtain, we may need to look at some of these additional incentives or carrots.

Mr. Chairman, just to make sure it is on the record, electronic filing does save the Federal Government an awful lot of money. It does save the taxpayers an awful lot of money and hassle. And it is certainly something that from a public policy point of view we ought to be encouraging.

Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you, Mr. Portman.

I have just got one basic question, but before that, I am fascinated, Mr. Harris, with your talk about the alternative minimum tax, because that really is a big, big problem. Would you want to expand on that a bit?

Mr. HARRIS. Sure. It is becoming a bigger problem every year. I think that one of the big problems with it is it is perceived so poorly. You get a deduction under the regular tax, and all of a sudden you have to compute a second layer of tax, and now it is taken away from you. So it is perceived as a very unfair tax.

I think when you look at the reason the alternative minimum tax was created, it is no longer serving that purpose. We don't have the tax shelters that we used to have. It is also a very complex area of the code. Let's take depreciation, for example. You have to calculate the depreciation on the asset one way for regular tax and a second way for alternative minimum tax and then decide if you have enough tax preference items to owe a second layer of tax. So it is very complex, it requires a lot of paperwork, and it is viewed as unfair.

I think a more honest approach is needed. If the revenue is the issue, we should adjust something so that we are collecting the same revenue, but we do it in a way that people are not feeling like they are getting backhanded with a second tax that they knew nothing about.

Chairman HOUGHTON. I have got a couple of other questions. Mr. Ernst, you mentioned the fact—and I think I quoted this—that in the IRS planning report they figured by the year 2005 they would have 33 percent on electronic filing and that by the year 2007, 70 percent or 80 percent. And then the Commissioner said in the year 2005 we are thinking about 40 or 50 percent.

Have you heard any contradiction of those numbers?

Mr. ERNST. Let me address that. What the Service has done is in several different cases they have quoted ranges about what they would expect in terms of electronic filing. And what Commissioner Rossotti quoted this morning was, I believe, between 44.5 and 61.6

million returns would be filed electronically by 2005, from IRS' Electronic Tax Administration Strategy for Growth (p. 51).

In a separate Statistics of Income Bulletin for Winter 1998-1999 (p. 185), they have used the low end of that range, or 44.5 million returns, which, if calculated based upon the 135.2 million returns that are expected to be filed in 2005, is approximately 33 percent. That is how the math works.

Chairman HOUGHTON. Right. OK.

Now, Ms. Rodgers, that is a fascinating ad that you had, "Free Fast Tax Refund Loan: Bring in your W-2 and your 1099 forms to obtain quick cash." If I understand it correctly, if you do this, somebody goes over your forms with a fine-tooth comb and then anticipates the type of return you are going to get and, therefore, will give you a loan on that? Is that the process?

Ms. JOYNER-RODGERS. This ad comes from the local area, I believe, from one of our members that submitted it. And we weren't quite sure what this ad meant, either, because it did give us concern. They said bring in your W-2s, bring in your 1099s, and we will electronically file your return.

It doesn't say anywhere they are preparing your return, but that leads you to believe that somebody has to be preparing the return. So this was a concern of ours.

Chairman HOUGHTON. I wonder whether it is legal.

Ms. JOYNER-RODGERS. I don't know. It was just brought in as a concern.

Chairman HOUGHTON. All right. Well, look, I guess the final question, really, is: If you had one specific suggestion to make to the IRS with your knowledge and your background, maybe each of you would like to tell us now. How would you start, Mr. Ernst?

Mr. ERNST. I would encourage the IRS to continue to work to reach out to the practitioner community to help them achieve their objectives. And I believe that is particularly relevant when it comes to objectives like electronic filing.

Chairman HOUGHTON. How about you, Mr. Harris?

Mr. HARRIS. I think the one suggestion I would give to the IRS is continue to emphasize training, to understand their customer as well as they need to, understand the perspective from which they come. I think practitioner groups can be very valuable in that, but I think if you don't understand the issues that are being dealt with on the other side, it is very hard for you to provide service that that person is going to feel is of high quality.

So I think training is going to be a key component. I think the divisions within the restructuring bill hopefully will lead to better training and understanding the customers that they will need to deal with. So I would say training is always the No. 1 thing I would advocate.

Chairman HOUGHTON. All right. Ms. Rodgers?

Ms. JOYNER-RODGERS. I agree that training is very important. I go along with that. Along those same lines, I think the attitude change, the shift of being more receptive, to listen to practitioners, taxpayers, willing to dialog with them. It is very, very important to keep the channels of communication open.

Chairman HOUGHTON. So what I hear is, with the possible exception of the training function, that internally they are doing a pretty

good job, but the goal really is to have greater merchandising and outreach to the customers.

All right. Fine. Thank you so much for being with us. We really appreciate it.

The meeting is adjourned.

[Whereupon, at 3:25 p.m., the hearing was adjourned.]

[A submission for the record follows:]

INDIANA DEPARTMENT OF REVENUE  
INDIANAPOLIS, IN 46204  
April 21, 1999

A. L. Singleton  
Chief of Staff  
*Committee on Ways and Means*  
*U.S. House of Representatives*

Dear Mr. Singleton:

Please accept the attached report for inclusion in the printed record of the hearing on the 1999 Tax Return Filing Season and the IRS Budget for Fiscal Year 2000.

We believe the Indiana Department of Revenue has developed a very unique processing technique that has potential applications in other tax agencies. The use of two-dimensional barcodes on tax returns provides the accuracy and efficiency of electronic filing while providing customers with the filing method of their choice. It builds the bridge from paper to electronic filing.

The attached report includes a description of the program, its strengths and weaknesses, and processing statistics through today with 81% of all Indiana returns logged into our Returns Processing System for the 1999 filing season.

Any questions or requests for further information on the two-dimensional barcoding program can be directed to me by phone at (317) 232-8039, fax at (317) 232-2103 or e-mail at kmiller@dor.state.in.us.

Sincerely,

KENNETH L. MILLER  
*Commissioner*

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### **Indiana Department of Revenue: Two-Dimensional Barcoding of Tax Returns**

#### **INTRODUCTION**

Electronically filed (paperless) tax returns are the goal of all tax agencies around the world. By eliminating paper, tax information can be processed faster, more accurately and at lower cost, but the simple fact is taxpayers are not moving in that direction fast enough.

The Indiana Department of Revenue processes 2.8 million individual income tax returns each year. Returns can be filed electronically with Indiana through the Federal/State Joint Electronic Filing Program, Federal/State Joint TeleFile Program, Federal/State On-Line Filing Program, and via the IT-40 Express, our direct Internet filing program; allowing taxpayers to file the way they want. However, each year about 2.2 million returns are filed on paper. Since more than half of those paper returns are computer-generated, the ability to put a two-dimensional barcode on them would allow for faster processing of that paper.

With less than a \$50,000 investment, the Department of Revenue has been able to add barcodes to tax returns and process them in a fraction of the time it takes with traditional paper. This new procedure will be the bridge from paper tax filings to paperless electronic filings.

#### **DESCRIPTION OF PROJECT**

Indiana receives over 2.8 million individual income tax forms each year, half of which are received in the two weeks surrounding April 15th. Use of electronic filing has replaced about 500,000 of these paper documents, and is growing every year, but unfortunately, not fast enough. Many Indiana taxpayers are still more comfortable filing a paper document through the mail. While this reluctance to filing electronically exists, other means are necessary for a smooth transition from paper



filing to electronic filing. Since more than half the paper forms received by the Department are computer-generated, they are available in electronic format at some point. By using that electronic format to produce a two-dimensional (2D) barcode, we eliminate the need for the Department to prepare paper for data entry and re-key the form information. We can treat barcoded paper like an electronic return.

The use of a 2D barcode on the tax return is a new and exciting use of existing technology. When the Department receives a tax return containing a 2D barcode, the return will be scanned into the system and eliminate the need to re-enter the return. Currently, a number of states are using expensive imaging applications to scan returns into their processing systems, but they must prepare the documents, scan them, and then reattach any W-2 forms and additional information. They also have to review entries that the processing system could not read during the scanning process and fix any miscalculations or other errors the taxpayer may have made while preparing the return. Because the barcode is produced by tax preparation software, the computations for the tax return have been verified, eliminating the common errors in manually completed tax returns. This allows the Department to scan correct information into the system and saves on error correction time. The scanning further eliminates the errors introduced by manual data entry when the return is re-keyed into the processing system.

Discussions with Symbol Technology and Andersen Consulting to implement 2D barcode technology on Indiana's tax returns began in July 1998. By August, the Department of Revenue was ready to begin discussions with tax preparation software developers about incorporating this technology into their existing Indiana tax packages. At the National Association of Computerized Tax Processors (NACTP) Conference in Milwaukee, an initial request was made for "any company to pilot the program." H&R Block stepped forward. The Department also asked Access Indiana Information Network, the State of Indiana's Internet service provider, to include the barcode in the Internet filing program they were developing.

The Department provided the tax preparation software vendors with the piece of software (DLL) they needed to print the 2D barcode as they print a completed tax form. The tax preparation software is then used by individuals and paid preparers to complete tax forms (including schedules and W-2s). When the user decides to print, the completed tax form is printed with a 2D barcode in the upper right-hand corner. This barcode contains all of the information from the form, schedules, and as many as 10 W-2s. The tax forms, schedules, and W-2s are then signed and mailed as usual by the taxpayer.

When received by the Department, the barcoded returns and associated payments are scanned directly into Indiana's integrated tax system for processing. The integrated tax system contains the software necessary to decode and decompress the data contained in the 2D barcode. These returns are then validated for compliance, and posted as any other return.

H&R Block was able to complete testing in December, allowing them to install software that would generate paper Indiana tax returns in all their outlets. Access Indiana completed testing on the barcode portion of its program in January 1999; its program went live on the Internet on February 5, 1999. Less than six months was needed to implement barcoding in Indiana from initial discussions to final product rollout.

#### SCOPE OF PROGRAM

For the 1999 filing season, Indiana piloted the use of barcoded IT-40s, full-year resident individual income tax returns. This form was chosen because of the large volume of non-electronic returns, the narrow processing time requirement, and the large amount of data that needs to be captured.

The trend in filing within Indiana is for approximately 1 million of the 2.8 million individual income tax filers to wait until April 15 to file their returns. Electronic filers traditionally file early in the season then trail off toward the filing deadline. The influx of paper on April 15 and 16 at our Returns Processing Center creates a traffic jam of paper which needs to be processed within 90 days after April 15 per state law to avoid additional expense for the state.

Additional manpower is needed for the paper preparation and manual data entry on those returns. Paper returns are placed in batch files of 90 for processing purposes. A batch of regular paper returns takes over four hours of manual paper preparation and data entry. The equivalent steps for a batch of barcoded returns can be completed in less than 15 minutes.

The error rate for regular paper returns received and keyed is approximately 12%–14%. Those errors may be caused by any combination of taxpayer errors, such as transposed numbers, math errors, illegible writing, and incomplete returns. Addi-

tional errors can be added during the manual data entry process. Barcoded returns, on the other hand, have an error rate of less than two percent. The error rate is reduced by the computer validations in the software programs and the elimination of manual data entry.

#### STRENGTHS AND WEAKNESSES

The Department started receiving barcoded IT-40 tax returns at its Returns Processing Center in late January. As of April 21, 1999, nearly 92,891 barcoded returns have been processed. Based on the percentage of computer-generated paper returns received in past years, we anticipate well over 100,000 barcoded returns being processed during 1999.

- A batch containing 90 regular paper tax returns takes approximately four and one-half hours of manual handling for paper preparation and data entry while a batch containing 90 barcoded returns takes less than 15 minutes of manual handling.

- Barcoded returns have more than a 99% "read rate" meaning fewer than 1% have to go through regular paper preparation and data entry procedures.

- Returns containing errors are suspended in the processing system and reviewed by tax analysts. The 10% reduction in errors (10,000 suspended transactions) translates into additional savings of 330 man-hours.

The end result for the taxpayers is a faster refund for them and more accurate processing at a reduced cost to the state. Faster, more accurate refunds also mean fewer telephone calls from taxpayers checking on the status of their checks.

An aspect of the 2D barcode program that professional tax practitioners appreciate is the response of their clients. Taxpayers, who have been reluctant to accept electronic filing or forms designed specifically for automated processing, feel comfortable with barcodes. Barcodes have become commonplace in today's society from supermarkets to department stores so their addition to the tax form is a natural evolution.

Any 2D barcode program does require support from software developers, that is why the Department approached the NACTP in August of 1998. Software companies who develop Indiana tax preparation software packages and want to include barcodes on their paper forms, have to install the DLL file to generate the barcode, they also have pass testing with the Department of Revenue to make sure that barcode is working properly.

Some software companies have expressed concerns about the barcoding program and how it may affect their software development schedules. Issues such as the size of the DLL, the size of the resulting barcode image, what printers can print the barcode, and what platforms are supported, are common. The Department issued a new revision of our specification package for barcoded IT-40 returns in mid-April, 1999.

At this point in time there are three approved companies to produce barcoded Indiana returns:

- Access Indiana is an Internet filing provider,
- H & R Block is producing barcodes in their individual outlets nationwide, and
- CSI (Creative Solutions), who only completed testing in March 1999, has a tax preparation package that is primarily distributed to individual tax professionals.

Each of the approved vendors has vastly different target audiences and distribution methods for its products. These differences show how the barcode can be successfully incorporated into a variety of programming situations.

#### FINAL ANALYSIS

When viewed as a "bridge to the paperless world, 2D barcodes on tax returns has definite benefits in both cost savings and customer service. The following statistics are based on barcode processing through April 21 of this year, or 92,891 barcoded returns.

- The cost of scanning a barcoded refund return is \$.04. The cost of scanning a barcoded remit return is \$.07.

- The cost of data entry for a regular paper refund return is \$.73. The cost of data entry for a regular paper remit return is \$.86.

Taxpayers who file barcoded returns during the 1999 filing season are getting refunds in a fraction of the time it takes to for those who filed regular paper returns. The Department has received H & R Block barcoded returns from Indiana taxpayers in 48 states plus Guam and the District of Columbia.

The project cost approximately \$35,000 in scanning equipment and took 200 work-days to complete; the grand total invested by the Indiana Department of Revenue was less than \$50,000. Additional forms will be added at little cost, and with less

effort than the pilot program. The software already provided to software vendors can be reused for additional forms within the Indiana Integrated Tax system.

The goal for this filing season was to process 100,000 barcoded returns. With that goal realized, the reduction in data entry cost and in error correction cost will mean that this new system has already paid for itself.

The Indiana Department of Revenue wants to increase voluntary compliance by redefining revenue agency customer service. By allowing customers to interact with the agency on their own terms, by selecting the filing method of their choice, voluntary compliance is encouraged. There are currently four true electronic filing options to Indiana taxpayers: Federal/State Joint Electronic Filing Program, Federal/State Joint TeleFile Program, Federal/State On-Line Filing Program, and IT-40 Express, the direct Internet filing program. But as long as 2.2 million taxpayers want to hold on to paper, attention needs to be focused on how that paper is processed.

